SPECIAL ISSUE ON THE BUSH PRESIDENCY

The Economist

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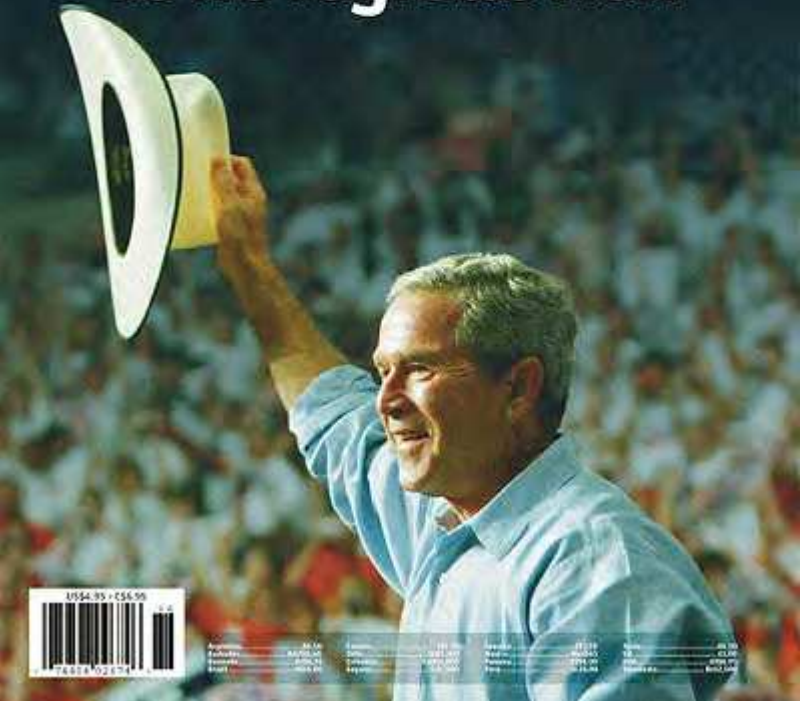
Je ne regrette rien



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After a tumultuous first term, George Bush has much to be proud of—and much to reconsider … More on this week's lead article

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Politics this week

Aug 26th 2004
From The Economist print edition

Sistani intervenes

AP

Ayatollah Ali al-Sistani, **Iraq's** most senior Shia cleric, led a convoy of supporters to Najaf in the hope of ending, peacefully, the siege of the Imam Ali shrine, where the young Shia firebrand, Muqtada al-Sadr, is holed up with his militia. Earlier, a suspected mortar attack killed a score of people in a mosque in the nearby town of Kufa.

See article

Britain's foreign secretary, Jack Straw, visited **Darfur** in western Sudan to assess whether the Sudanese government is trying to end the ethnic cleansing there. He reported a mixture of progress (more aid workers have been allowed in) and problems (pro-government militias still kill with impunity). Sudan has until the end of the month to satisfy the UN or face unspecified sanctions.

See article

The main Tutsi-led political party pulled out of **Congo's** power-sharing government, sparking fears that the country may be about to slide back into civil war.

See article

In **Zimbabwe**, the main opposition party, the Movement for Democratic Change, announced that it would not contest the next election, since the government was sure to rig it.

Two **Kenyans** were jailed for embezzlement: the first to be convicted since President Mwai Kibaki came to power 20 months ago promising to curb corruption. Their scam involved taking public money to import London black taxicabs, and then not importing them.

Mark Thatcher, son of a former British prime minister, was arrested in **South Africa** on suspicion of involvement with an alleged coup plot against the despotic president of Equatorial Guinea. He was released, but ordered to appear in court in November.

Kofi Annan, the UN's secretary-general, called on **Israel** to drop plans to expand its West Bank settlements.

Victims of terror?

Two **Russian planes** mysteriously crashed within a few minutes of each other, killing all their passengers and crew. The coincidence raised fears that the 89 dead were victims of renewed Chechen terrorism, just a few days before Chechnya's presidential election. But there was no hard evidence of foul play.

See article

Hungary's prime minister, Peter Medgyessy, stepped down. His replacement, chosen by a special Socialist Party congress, will be Ferenc Gyurcsany, a multi-millionaire.

See article

The **Czech** parliament passed a vote of confidence in their country's new prime minister, Stanislav Gross.

Protesters threw eggs at Chancellor **Gerhard Schröder**. Increasing numbers of Germans, especially in the depressed east of the country, have been taking to the streets every week to demonstrate against welfare cuts. The German economy remains glum: domestic demand shrank in the second quarter.

France celebrated the 60th anniversary of the **liberation of Paris** on August 25th 1944, with most of the credit for driving out the Germans apparently going to General de Gaulle's French forces rather than the Americans, British or Canadians.

Delivered by hand

In **Venezuela**, a sample manual audit by foreign election observers confirmed that President Hugo Chávez really did win a recall referendum by a substantial margin. His opponents had alleged that electronic voting machines had been manipulated.

Police in **Brazil** seized 1,320lbs (600 kilos) of ore containing uranium and thorium, another radioactive metal, from a clandestine mine thought to be at a remote site in the Amazon jungle.

Colombia's FARC guerrillas rejected a government offer to release, under supervision, 50 low-ranking guerrilla prisoners in return for the freeing of 72 hostages held by the rebels. They include a former presidential candidate, Ingrid Betancourt, and three Americans on contract to the State Department.

What did you do in the war?

Reuters

John Kerry filed a complaint with the Federal Election Commission against TV adverts made by Vietnam veterans attacking his war record and accused George Bush's team of backing the group. Mr Bush called for a ban on all ads by independent political groups using loopholes to circumvent laws on campaign funding. Meanwhile, an ad made by Mr Bush's campaign equating Iraq's participation in the Olympics with its “freedom” was criticised by the Iraqi football squad in Athens.

See article

The first hearings by military tribunals began for **terrorist suspects** held at Guantánamo Bay. Four men were charged with a range of crimes. The Pentagon insisted the trials would be open to scrutiny but human-rights groups complained they were unfair.

See article

Two reports on the prisoner abuse scandal at Iraq's **Abu Ghraib** prison criticised senior commanders and top administration officials for failure of “oversight”. But the reports found no evidence that they actually ordered the mistreatment.

Pat Roberts, chairman of the Senate Intelligence Committee, outlined a new act that would split the CIA into three parts and overhaul America's **national-security apparatus**. It received a lukewarm reception from the spooks.

See article

Contradicting Mr Bush's support for a federal ban on **gay marriage**, America's vice-president, Dick Cheney, said that the issue would be best handled by the states. But he reiterated that Mr Bush would set policy on the matter.

End of the road block

A blockade of Katmandu by Maoist rebels in **Nepal** ended after a week. Analysts said the rebels had damaged their cause by alienating potential supporters.

See article

Japan said it will deport Bobby Fischer, a former world chess champion, who is wanted in America for breaking UN sanctions by playing in a chess tournament in Yugoslavia in 1992.

In **Bangladesh**, strikes shut down much of the country in protest at the attempted assassination of the country's opposition leader, Sheikh Hasina. Her party blamed Islamic extremists who are, it claimed, sheltered by the country's government.

AP

See article

Shaukat Aziz, a former banker, was due to be sworn in as prime minister of **Pakistan**.

See article

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Business this week

Aug 26th 2004
From The Economist print edition

Shelling out

Royal Dutch/Shell agreed to pay $120m to American regulators and £17m ($31m) to their British counterparts to settle charges relating to a vast overstatement of its oil reserves. A damning report from America's regulators suggested that the overstatement began earlier and was more widespread than Shell had admitted. In a further setback, Nigeria's Senate decided to pursue Shell for compensation of $1.5 billion for causing environmental damage in the country during 50 years of oil production.

See article

Yukos's shares fell again after reports emerged that the beleaguered Russian oil company was about to get another tax bill from the government of some $3 billion on top of the $3.4 billion that it already owes. Meanwhile, Yukos said it planned to cut production for the year by about 4.5% and slash costs by some $700m.

See article

Abbey bidding

A bidding war for **Abbey**, a British bank, seemed closer after Spain's **Banco Santander Central Hispano** said it would not drop out of the contest if HBOS, Britain's third-largest mortgage lender, entered the fray. Meanwhile, HBOS complained to the European Commission about SCH's £8.3 billion ($14.9 billion) agreed bid for Abbey, citing concerns about cross-shareholdings between Royal Bank of Scotland and the Spanish bank. Rumours circulated that Abbey had allowed HBOS a peep at its books.

Sumitomo Mitsui Financial Group made an attempt to stymie **Mitsubishi Tokyo Financial Group's** takeover plans for the weakest of Japan's “big four” banks, **UFJ**. Sumitomo unveiled a ¥3.2 trillion ($29 billion) bid for UFJ, which the smaller bank is unlikely to entertain.

See article

Citigroup took steps to capitalise upon growing prosperity in Texas with the acquisition of **First American Bank** for an undisclosed sum, rumoured to be some $750m. Citigroup will get $3.5 billion in assets and over 120,000 customers in the state.

Lowering-cost airlines

Talks broke down between **US Airways** and its pilots' union about cutting costs by some $300m. America's sixth-largest airline is also seeking big concessions from other employees to avert bankruptcy.

Alitalia shares hit an all-time low after it said that financial calamity looms unless unions agree to cut costs to ensure access to fresh loans.

Singapore Airlines agreed to buy up to 31 long-range jets from Boeing in an order worth up to $7.4 billion. The order will help Boeing to make up ground on Europe's Airbus, which overtook the American firm as the biggest supplier of passenger aircraft last year.

British Airways settled a dispute with check-in staff and baggage handlers that had threatened to disrupt travel over the busy bank-holiday weekend. But thousands of passengers suffered anyway when the airline cancelled flights in the run-up to the weekend, blaming staff shortages, bad weather and technical problems.

See article

Local difficulties

In a dispute that has rumbled on for eight years, **Verizon Communications** and **Qwest Communications** asked an appeals court to overturn temporary rules imposed by the Federal Communications Commission that forces them and other local phone companies to share their lines with rivals at a fixed price. In March, a court threw out the FCC's previous rules that allowed access by rivals at rates set by the government.

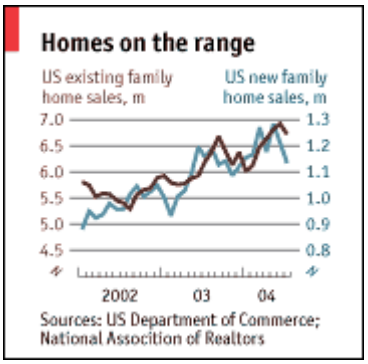
ARM Holdings, a British chipmaker, agreed to pay $913m for **Artisan Components**, an American rival. ARM said that the deal would serve to expand its range of products. Disgruntled investors thought the price too high, sending ARM's shares plunging by 19% in one day.

Attempts by **Microsoft** and **Time Warner** to create an industry standard for software designed to thwart illegal file sharing of films and music over the internet ran into trouble. The European Commission said that concessions offered by the pair to soften antitrust objections to their takeover of **ContentGuard**, a security-software firm, were insufficient and began a full probe of the deal.

Beer lovers were divided over the latest innovation from Alcoa and the Pittsburgh Brewing Company: the **aluminium bottle**. The revolutionary packaging system will keep beer colder for longer and ease recycling, though purists claim that beer stored in glass is tastier.

Bricks and mortar

America's housing market remained buoyant in July despite a decline in sales from June's towering peak. Purchases of new properties fell by 6.4% to a still impressive 1.1m units. Another 6.7m existing homes changed hands, a decline of 2.9%.



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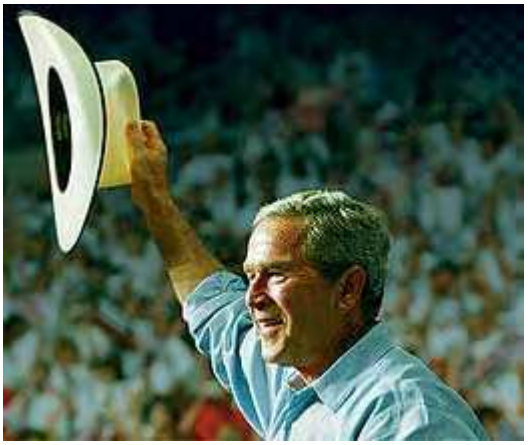
The Bush presidency

Je ne regrette rien

Aug 26th 2004
From The Economist print edition

After a tumultuous first term, George Bush has much to be proud of—and much to reconsider

AP



FOUR years ago, George Bush presented himself at the Republican convention in Philadelphia as a “compassionate conservative”. After the dramas and division of the Clinton years, the Texan dynast, backed by reliable old hands such as his running-mate, Dick Cheney, would provide a more modest, grown-up approach. Abroad, Mr Bush promised a humble but strong foreign policy. At home, there would be a big tax cut, affordable thanks to the large budget surplus—and, unusually for a Republican, Mr Bush talked a lot about social issues such as education. After two Republican conventions with the Christian right in full cry, he softened the party's stance on social issues at Philadelphia, and gave a hearing to homosexuals and minorities. This prospect of a moderate presidency was further advanced, or so it seemed, by the narrowness of his election victory: having won fewer votes overall than Al Gore, Mr Bush promised to be a president for all Americans.

Now Mr Bush approaches next week's convention in New York a very different figure. The “accidental presidency” has become a transformative one (see article). The divisions within America are much greater than they were under Bill Clinton. Our YouGov poll this week shows that, although 86% of Republicans approve of what their president is doing, a mere 8% of Democrats do. Abroad, the “polarisation” is less evident only because so few Europeans are prepared to take the side of the smirking “Toxic Texan”. Those “safe hands” advertised at Philadelphia four years ago—men such as Mr Cheney and Donald Rumsfeld—are now more often cast as ideological revolutionaries, often fiendish ones.

There is exaggeration in this, and often crass anti-Americanism (more on that later). But the vitriol and adoration that Mr Bush inspires both stem in part from the policies he has chosen. It is not just a matter of waging the most controversial war since Vietnam and dramatically increasing the size of government. Name your subject, from education and health care to missile defence, AIDS policy, gay marriage, stem cells and civil rights, and this presidency has sought radical change.

Promises, promises

Radicalism can be good—but Mr Bush's brand has turned a compassionate conservative into a contradictory one. What is conservative about allowing government to grow faster than under Mr Clinton? What is humble about announcing that you are trying to introduce democracy to the Middle East? Where is the compassion in his support for a federal ban on gay marriage, the limitations on stem-cell research or his other moves to accommodate the zealots of the Christian right?

In a race where Mr Kerry now seems to be the narrow favourite, the president is going to Madison Square Garden promising, in large part, more of the same. Yes, there will be an attempt to reach out to independent voters: moderates such as Arnold Schwarzenegger and Rudy Giuliani have been given prominent speaking slots. But Mr Bush is undaunted. His message is that America should stick with a man who faced hard choices and took the right decisions. *Il ne regrette rien.*

For this newspaper, that verdict looks mostly right for Mr Bush's foreign policy. The charge that he set off in a needlessly unilateralist direction on taking office is vastly overdone; he sought allies throughout; and

in many ways his forthright style was a breath of fresh air after the muddle and evasions of the Clinton era. Yes, he dropped out of the Kyoto Protocol in a tactless way; but that was a bad treaty which America was never going to accept in any case (the Senate voted against it by a margin of 95-0). Mr Bush upset many people by ripping apart the outdated anti-ballistic-missile defence treaty with Russia—then baffled his critics by getting both Russia and (more hesitantly) China to go along with him.

But it was the thunderbolt of September 11th that counted most. Those atrocities set the course for the remainder of his presidency. Since then, we continue to think that Mr Bush has got the big foreign-policy decisions right. He understood the nature of the war that had been declared against America and the western world. He made it clear that it is not a war between civilisations, let alone religions; but he has also served notice to Arab regimes of the need to change. He rightly decided to destroy al-Qaeda's home in Afghanistan—and, yes, on the evidence that presented itself at the time, he rightly decided to invade Iraq.

Could France be mistaken?

Many of these decisions were bound to be unpopular with his allies. That does not make them wrong. Nor does it justify the anti-Americanism that many politicians have recklessly tried to stir up, particularly over Iraq. Some Bush-bashing foreign governments seem to hope that Mr Kerry will adopt a different set of priorities. Tellingly, he has stuck pretty close to Mr Bush.

To be sure, the president has got some things wrong in foreign policy. He did not outright lie about Iraq's supposed weapons of mass destruction, but he misled the country about what was known and not known. His administration exaggerated the case for invading Iraq in another way too, by falsely linking Saddam Hussein to al-Qaeda. Elsewhere, his failures have mainly been errors of execution.

He called for the establishment of a Palestinian state, but did little to support it. In Iraq, he destroyed a dangerous and odious tyrant, but lamentably failed to prepare for rebuilding the country after fighting what was, whatever Mr Bush says, a war of choice. And, in a conflict where hearts and minds count for so much and where America's reputation has been so badly wounded, the president was unwilling to acknowledge the gravity of the abuses at Abu Ghraib. That calamity warranted the resignation of Mr Rumsfeld. (The fact that a commission this week cleared him of direct responsibility for the torture is beside the point. He was the man in charge.)

Effective execution is partly a matter of experience. There are signs, including in Iraq, that the Bush administration has learned from its mistakes. *The Economist*'s bigger disagreements with Mr Bush lie beyond the war on terror, in areas where Mr Bush's very aims are questionable or worse.

The “accidental presidency” has become a transformative one

This president, despite impassioned avowals to the contrary, has been no champion of open international markets. He caved in to protectionist pressures and imposed tariffs on steel; he also signed an absurdly bad farm bill. His fiscal policy is nothing to boast about either. Here Mr Bush can plead with some justification that, as with foreign policy, he was ambushed by events: yes, he inherited a Clintonian budget surplus, but he also had to deal with the burst Clintonian bubble. A big swing into deficit was needed, he would argue, to avoid a much worse recession. Up to a point, Mr President. Unfortunately, the Bush deficits are not temporary. They stretch into the distance: the ten-year deficit is projected at $2.7 trillion, even after a lot of dodgy accounting. He cut taxes in the best conservative tradition, but spent vastly more as well. Mr Bush is a conservative who believes in big government.

This failure to curb public spending is all the more alarming because the next president will have to prepare America for the retirement of the huge baby-boomer generation. Four years ago, Mr Bush talked, albeit tentatively, about partly privatising the pensions system; almost nothing has been done. And he has made the fiscal burden of entitlement worse by increasing the prescription-drug benefit in the Medicare system—again without undertaking meaningful reform.

The other problem is social policy. The American conservative movement has always been a marriage between “western” anti-governmentalism and “southern” moralism. Four years ago, Mr Bush made no secret of his own religious beliefs, but he gave the impression he would hold the often intolerant religious right in check. Instead, he has given it a big role in his administration on a host of issues. No doubt Mr Bush's convictions are sincere; but they were not to the fore in 2000 and they are not shared by many of those who supported him then, nor by this newspaper.

Tumultuous though it has been, and despite the passions it arouses, Mr Bush's first term should in the end be judged in the same measured way as most previous ones. It is a mixed bag: successes and failures must be set beside each other. And deciding whether Mr Bush deserves a second term calls for more than an appraisal of his own record: the American people will have to judge whether Mr Kerry, another mixture of good and bad, represents a better choice. At his convention in Boston, Mr Kerry made an effort to cast the Democratic Party in a new light. Mr Bush needs to attempt something similar in New York. More of the same just will not do.

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Click to enlarge our cover image of George Bush, and to hear Edith Piaf (MP3 format)

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India and Pakistan

The technocrats take over

Aug 26th 2004
From The Economist print edition

India and Pakistan both have technocrats in charge. This is only partly a good thing

Reuters

SHAUKAT AZIZ, a banker turned administrator who serves his country free of charge, was due to be sworn in as prime minister of Pakistan on August 28th. His elevation brings a curious, and in many ways pleasing, symmetry to governance in the sub-continent's two nuclear-armed giants. Both will now have prime ministers who are technocrats: Mr Aziz hails from Citibank; India's Manmohan Singh was a much-respected academic economist. Both men were drafted into politics late in life as finance ministers before getting the top job. Neither is a politician in the conventional sense. Mr Singh has never won a democratic election: he sits in India's nominated and indirectly elected upper house. Mr Aziz did not enter Pakistan's lower house until last week, when he won two safe by-elections expressly called for the purpose of installing him as prime minister.

Both technocrats proved huge successes in their finance portfolios. Mr Singh, in the early 1990s, was credited with being the brains behind India's most reformist government ever. Mr Aziz has turned around Pakistan's economy since General Pervez Musharraf seized power in 1999, making full use of the American largesse that has flowed in since September 11th 2001. So with Mr Singh and Mr Aziz running things, is the future of South Asia now in the safest of hands?

In many ways, yes. Although ultimate power in Pakistan will continue to rest with General Musharraf, it is reasonable to expect continued good economic management on both sides of the India-Pakistan border. And the fact that two such even-tempered and practical people are in charge should bring a more profound recognition of the huge benefits, in the form of trade and investment, that could accrue to both countries if their relations were conditioned more by economics and less by the destructive politics of Kashmir.

Yet Mr Aziz's appointment, good on the economic front though it may be, looks in many ways like inept politics. General Musharraf has promised that by the end of this year he will relinquish the post of army chief, while hanging on to his president's hat and his chairmanship of the National Security Council. He has already shown signs of resiling from this commitment. Whether he honours it or not, Pakistan's politics suffer from a large democratic deficit, which will hardly be corrected by the shoe-horning in of a prime minister with no independent political base who is so obviously the president's man. Pakistan's parliament has been subject to frequent boycotts and walkouts, so infuriated have its members become by the interference of the men in khaki. Mr Aziz will be in no position to restore parliament's authority.

The situation is less dire in India, because the system there contains more than enough democracy to compensate for Mr Singh's unorthodox route to power. Even so, there is already the beginning of a worry. Brilliant technocrat he may be: but does Mr Singh possess the gutsy political skills he needs to hold together his ramshackle coalition, and the communicative ability to sell uncomfortable changes to the electorate? So far, the signs are not encouraging. The cabinet contains some frighteningly useless coalition members, and the government's first budget was uninspiring, ducking most of the tough issues and promising more handouts, not fewer. Officials are already muttering that Mr Singh needs to get out more and sell his ideas to the country. But they don't teach you how to do that in banks or universities. You learn it on the stump.

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Third-world water and the private sector

How not to help those in need

Aug 26th 2004
From The Economist print edition

Some activists want big water firms out of the developing world. Unfortunately, they may succeed

Panos

IN THE developed world, the stuff comes 24/7 from the tap. In poor countries drinking water comes out of taps, communal standpipes, the water-seller's cart, wells, boreholes, streams or puddles. It is apt to come irregularly, at some times and places not at all. Then some people die. Vastly more die in many poor countries from the non-existence or inadequacy of sewerage systems. Little wonder that water is a fiery topic.

In Bolivia in 2000 an issue of water supply led to riots and a state of emergency. Why? Because a private-sector consortium including Bechtel, a big American contractor, had been brought in to improve supplies to the city of Cochabamba and charges were raised to pay for the investment. The affair has become a classic among those non-governmental organisations (NGOs) and anti-capitalists who argue that water falls free from the sky, is a basic human need and right, and so no one should profit from supplying it. All of which is true, except the conclusion. Rain falls free, but someone has to spend money and deploy skills in getting it to the tap, and removing it in a sewer. The best organisation to do this may well be a profit-driven water company. Most of those who rail about Cochabamba do not also remind their listeners of the woeful failure of the city's previous public-sector water supplier.

Such woes are common in the developing world. So is a shortage of capital. No wonder the World Bank has long called for private-sector skills and money to be brought in. A good many local authorities have agreed. Governments and public agencies still finance nearly 90% of the poor world's $15 billion annual investment in water and sewerage; but private money pays for the rest. No wonder, either, that every so often the private sector makes a mistake, as anyone can: this new water-main or sewer is not built on time, or lack of rainfall means that a reservoir is dry. At that point fresh torrents of abuse swill around the world's NGO websites claiming proof, from one case of underperformance, that all private-sector involvement in third-world water is wrong.

The companies agree

Well, a shock awaits those who believe this. The world's three biggest water companies are coming to the same conclusion (see article) albeit for different reasons. As their opponents complain, they are not interested anyway in rural projects that can never show a profit. But now they are shy of urban projects too: even if consumers paid up, as many do not, the social, regulatory, political and currency risks are just too high. And with an army of critics on the watch, they risk bad publicity in the rich world as well. The result is likely to be a lot less private-sector involvement in the future.

For the world's poor, this is bad news. Things have been improving, as a new United Nations survey shows (see article). Yet a billion people still have to drink unsafe water, 2.5 billion lack safe sanitation. Much remains to be done. Can the private sector be kept at work? RWE Thames Water, one of the three biggest water firms, aided by sensible NGOs, has ideas for getting companies into modest schemes, short-term and simply as technicians, not investors or bill-collectors, and aiming only to break even. Wish them well. But if firms could be persuaded to remain directly involved in big urban projects as well, the work would go much faster. That may not be possible. But the army of critics could give a little help by reflecting that sneers from rich countries do not pipe clean water in poor ones.

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Sudan

Crunch time in Darfur

Aug 26th 2004
From The Economist print edition

If the world does not get tough with Sudan's government, the country could fall apart

Reuters

Get article background

THE number of murderous raids has decreased, but this is largely because there are so few villages left to burn. The Sudanese government's campaign of ethnic cleansing in the western region of Darfur is all but complete. Most Darfuris belonging to tribes deemed sympathetic to the black African rebel movements there have been driven from their homes by the *janjaweed*, the state-backed Arab militia. Perhaps a million are clustered in miserable camps within Darfur; another 200,000 or so have fled into neighbouring Chad. They dare not return home for fear that the government's hired hands will kill them. Even if they did go back, their livestock have been looted, their wells have been stuffed with corpses, and they have missed the planting season, so they would starve.

This catastrophe would have been easier to alleviate if the world had paid attention much earlier than it did—there was no shortage of warnings. But the challenge now is to try to prevent more innocent Darfuris from dying, and to do so in a way that neither rewards the Sudanese government for its cruelty, nor destabilises Africa's largest nation any further.

Last month, the UN Security Council issued a vague ultimatum. By August 29th, Khartoum must either demonstrate that it is curbing the *janjaweed* and allowing aid workers unimpeded access to Darfur's needy multitudes, or it will face unspecified penalties. That deadline is near, and it is unclear what the UN's verdict will be. On the one hand, the Sudanese government is obstructing aid workers less than before—a concession that has probably saved thousands of lives. On the other hand, it has made no serious effort to rein in its *janjaweed* allies. Rather than disarming them, it has been giving them uniforms and merging them with the security forces. That, says the International Crisis Group, a campaigning charity, leaves them “free to operate as servants of the state by day and *janjaweed* by night, to the double peril of civilians”.

The Sudanese government is slippery to deal with. It has consistently shown bad faith in past negotiations, gambling that the West's short attention span and commitments in Iraq will preclude any serious consequences for its actions. But it has its own internal rifts (see article) and it is pragmatic enough to bend when faced with overwhelming pressure. That is why it is crucial that the pressure should not slacken.

Unless the behaviour of the Sudanese regime shows an implausibly dramatic improvement in the next week, the UN should impose an arms embargo, and aim sanctions at the individuals behind its ethnic-cleansing policy and all businesses associated with the regime. The further threat of an oil embargo should be retained to give Khartoum an incentive to live up to its obligations.

To restore a measure of security to Darfur, many more foreign troops will be needed than the 150 or so Rwandans currently deployed. The African Union (AU) is keen to show that Africa can police itself; western powers should encourage it. The AU lacks cash, transport planes and the communications needed to project force over long distances. America and others should help with all three. The 3,000 soldiers that Nigeria and Rwanda are considering sending would be a start. A larger force would be better, but the first priority should be to get boots on the ground as quickly as possible, with a mandate to use any means necessary to protect civilians.

If you lean hard enough, they will bend

A lasting solution will require compromise between the government and the rebels. Given the hatred on both sides, and the government's fear that if it makes concessions to Darfuri rebels it will encourage other regions to rise up, this will be hard. The rebels are only marginally less brutal than the government, and are proving equally obdurate at negotiations currently under way in Abuja, the Nigerian capital. Both sides need to be leant upon to find some kind of middle ground.

Sudan is such a vast and ghastly mess that many outsiders would doubtless prefer not to get involved. When one considers that the country has been at war on and off since independence in 1956, and that 2m of its people have died in the past two decades as a result of the conflict between the Muslim north and the non-Muslim south, it would be easy to conclude that there is no hope. Easy, but wrong. Outside pressure, particularly from America, has brought the north-south war close to an end. In areas where it feels more secure, such as the capital itself, the government has grown less oppressive in recent years. Sudan can change. But if outsiders abandon it, it could fall apart completely.

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Russia and Chechnya

A poll that will solve nothing

Aug 26th 2004
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In Chechnya, Russia needs the help of the politicians it has chased into exile in the West

EPA

NATIONS which face a terrorist threat, originating at least partly from within their own borders, resent being told by outsiders that their problem cannot be solved by force alone. To realise that, ask almost any Israeli, Spaniard or Briton.

A defensive public mood—"leave us alone to deal with our terrorists in the only language they understand"—is already palpable in Russia. It will almost certainly grow stronger still after this week's air crashes (see article) whether or not investigators can prove that Chechen rebels were responsible.

But in the end, the truth or falsehood of a hard political message does not depend on the identity of the messenger. Understandably enough, Russians have little stomach for lectures about how to tackle the Chechen question. But at certain times, the Russian authorities themselves have behaved as though they already understood one of its basic truths: their security forces alone cannot bring peace between Russians and Chechens, even if you assume (perhaps too generously) that they really want to.

Earlier this year, the Kremlin appeared, in its own terms, to be having a slight degree of success with its policy of "Chechenisation"—which in practice meant shoving responsibility for the misery of Chechen life on to a local strongman.

Until his assassination in May this year, the man in question was Akhmad Kadyrov, a former mufti of Chechnya and erstwhile associate of the rebels who had switched sides. With his connections, his personal authority and the militia headed by his brutal son Ramzan, Mr Kadyrov seemed to the Kremlin to be the only choice for the dirty and dangerous mission of bringing Chechnya under control.

There is nobody else, it now seems, who can do that job. For the "election" due on August 29th—after the blatant rigging of Mr Kadyrov's poll victory last year, the quote marks are necessary—the official choice, as indicated by the usual barrage of favourable press coverage, is Alu Alkhanov, the Chechen interior minister. But Mr Alkhanov is a bureaucrat and policeman, not the mixture of politician, father figure, bandit and warlord that his late boss was, and which anyone hoping to pacify Chechnya by force would need to be. He may be merely a placeman to tide Chechnya over until the younger Mr Kadyrov comes of age.

To keep Kadyrov junior on side, Mr Putin has in recent days visited his home village and agreed to a proposal, first floated by his father, to give Chechnya not just the taxes but also the profits from oil pumped out of its ground, instead of money from the federal budget. That will give the republic's leaders a tighter grip on the purse-strings; it will also cause unhappiness among the Russian army officers who are resentful over concessions to the Kadyrov clan and would prefer to reintroduce direct military rule. But the signs are that Mr Putin is not happy with the army's role either. A daring rebel raid in June in neighbouring Ingushetia caught the security forces completely unawares and cost them dozens of lives. In the aftermath of that disaster, Mr Putin sacked or demoted the commanders responsible for Chechnya, including the head of the army, and moved responsibility for the army's day-to-day running from the general staff to the civilian defence minister. Yet leaving Chechnya as a place ruled by fear, whether imposed by the army or local bullies, is not a solution either.

Can anything better be done to provide Chechnya with legitimate governors? There are moderate rebel

representatives, but they are becoming less numerous, less moderate and less representative. Aslan Maskhadov, elected president in 1997, is still mooted by some as the only likely interlocutor for peace talks; to everyone's surprise, Mr Alkhanov recently said he would be open to meeting him. But as the overall mood darkens, Mr Maskhadov, from hiding, has taken a tougher line, claiming to have masterminded the incursion into nearby Ingushetia and promising others. The Russian authorities have worked to discredit him, and are furious at Britain and America for giving asylum to two of his ex-ministers, respectively Akhmed Zakayev and Ilyas Akhmadov, who have a good record as moderate and constructive figures.

Russians will no doubt insist that they are as entitled as anyone to protection against terrorism. That is true. But they will not prevail against the minority of Chechens who are irreconcilable extremists and collaborators with global terrorism unless they win over other Chechen hearts and minds. Unfortunately, the victor in the forthcoming ballot will not help much with that, but the sort of Chechens who are now sheltering in the West just might.

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Banks

Trading wars

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Worryingly, big banks are in danger of turning into little more than hedge funds

WHAT is the difference between a global investment bank and a giant hedge fund? Very little nowadays, it seems. Both play financial markets. The perceived investment skills of hedge funds, which aim to generate handsome returns in bad as well as good markets, are the reason why they have attracted about $1 trillion from investors. Investment banks, too, have long made money from trading on financial markets. So it may seem that there is little cause for concern.

In fact, there are real reasons to worry. Investment banks have always run trading desks of their own, but they once earned far more from other kinds of business—raising money for companies by selling securities to investors; giving advice on everything from tax to mergers; and acting as intermediaries in deals, from which they would take a fee. This spread of businesses offered them some stability and security. They are still in these businesses, but new technology and a flood of capital into the banking industry have meant that many are far less profitable than they were even a few years ago. For that reason, many investment banks—and commercial banks with investment-banking arms—have decided that trading is, after all, a wonderful business. They already seem to have forgotten the lessons of the late 1990s, when many reduced their trading activity because they thought it too risky.

More worrying still is the fact that the bets which banks are now making in their trading operations are much bigger because markets are less volatile. In such markets bigger bets are necessary to meet profit targets. And in consequence the biggest worry of all is what happens to the world's financial system if and when a large bank or fund runs into trouble as a result of trading losses. Because banks and hedge funds tend to pursue similar trading strategies, any sudden change in financial markets could cascade through the banking and hedge-fund industry. It has happened before. In 1998, many banks were pushed to the edge when Long-Term Capital Management, a giant hedge fund, fell apart; a financial meltdown was avoided only when the Federal Reserve co-ordinated a bail-out by the fund's bankers. The level of speculation is greater now than it was then.

Strangely, precisely how much greater is hard to say. Trading positions have certainly increased hugely over the past two years, and Deutsche Bank has been at the forefront of this trend (see article). The risk-management formulas used by banks, and approved by regulators, have allowed banks to increase their trading positions using the same amount of capital as market volatility has fallen. On top of that, they have bet more capital. Yet the true extent of their risks has been disguised by a peculiarity of regulation: banks are required to say what they earn from their own trading operations, but do not have to describe the nature of their investments in other firms. And they have declined to say how much of their capital is invested in hedge funds, thus disguising the extent of their risks.

Lights! No action

Most, perhaps all, of the banks now making a living by trading in the capital markets are “too big to fail”: that is, they can count on a government bail-out. Many also get cheap finance from deposits that are insured by the government. For both of these reasons, the temptation for them—and those of their employees that get fat bonuses from trading—is literally to bet the bank. A first step to reining in these bets would be to force banks to disclose their full exposure to trading by revealing how much of their capital is invested in hedge funds.

A second, complementary step, mistakenly rejected by the regulators who sit on the Basel committee, which sets minimum capital standards for international banks, would be to force banks to raise a significant portion of their capital in the form of subordinated debt, rather than equity. The idea is simple: holders of bank shares benefit from bumper profits, and so are likely to tolerate banks taking on bigger risks. Holders of subordinated debt, who come low down the pecking order of creditors, gain little from bigger profits, but could lose everything if a bank has to be bailed out. They are, in other words, just the sort of risk-averse investors to keep a hawk-like eye on trigger-happy traders.

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Letters

Aug 26th 2004
From The Economist print edition

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America's hard men

SIR – Lexington's musings on public displays of puissance by American presidential candidates fail to address the historical context of all this machismo (August 7th). Just over a century ago, Theodore Roosevelt, the youngest man ever to become president, made "the strenuous life" a hallmark of his administration. A legendary outdoorsman, Roosevelt fiercely advocated physical fitness while vociferously denouncing "a life of slothful ease". He was also a staunch imperialist and rooted much of his argument for an activist American foreign policy in the "vigorous, healthy life" of the individual. Roosevelt famously remarked that "it is only through strife, through hard and dangerous endeavour that we shall win the goal of true national greatness."

Recognising that America wants a sturdy leader and a strong foreign policy in a fragile world after the September 11th attacks, it is hardly surprising that both George Bush and John Kerry have appropriated his cult of strenuosity.

Peter Lattman
New York

Russian renationalisation?

SIR – Yukos and other state-owned enterprises were practically stolen from the incompetent Boris Yeltsin ("The future of Russian business", August 7th). I am not surprised that Vladimir Putin is trying to get the oil company back. The method is heavy-handed but how else could it be done and still keep the appearance that Russia has a functioning legal system?

B. Khalil
Pinole, California

Saving Afghanistan

SIR – You are right that conservation is much needed in environmentally ravaged Afghanistan ("Where foresters fear to tread", July 10th). But it is wrong to say that Americans have an "idea" to create an Afghan Conservation Corps (ACC) or that it would be useless in Pushtun areas because of security concerns. The American-funded ACC is more than an idea; it is a vigorous and spreading reality with nearly 100 projects nationwide. All of them, including the seven in Pushtun areas, have operated safely and effectively. The specific concept is American but the Afghans, who have a deep conservation ethic, asked for and fully support the ACC.

Not only is the ACC helping to conserve natural resources and biodiversity, it is employing thousands of vulnerable people, including women, the disabled and returned refugees. The model has worked so well there that we hope to replicate it in other developing countries with displaced populations.

Arthur Dewey
Assistant secretary of state
Bureau of Population, Refugees, and Migration
Washington, DC

Provincial attitudes

SIR – You are unreasonably harsh in your assessment of Pete Coors, Colorado's senatorial candidate ("Beer today, gone tomorrow?", August 14th). I have lived in Canada my entire life and like him I had no idea that Paul Martin was the premier of Canada; I had mistakenly supposed Mr Martin to be the prime minister. To what country does the province of Canada belong?

Timothy Giannuzzi
Calgary

No justice in Gujarat

SIR – You report on the mysterious inability of India's courts to prosecute the perpetrators of the anti-Muslim pogrom in Gujarat in 2002 ("It still hurts", August 14th). This you contrast with the vigour with which the Prevention of Terrorism Act has been deployed against those Muslims held to be responsible for the arson attack (or possibly accident) that claimed 58 lives, mostly Hindu, earlier that year.

Such double standards alas, should come as no surprise to anyone familiar with the way the Sikh community in Punjab was persecuted between 1984 and 1995. It is estimated that tens of thousands of Sikhs were murdered during that time by the army and police, and through mob violence; the police also practised a variety of torture methods, as documented by Amnesty International. So far, none of the police nor anyone else involved has been held to account, as the various commissions and committees and the Supreme Court, which are supposed to deliver justice, continually reduce the scope of their inquiries.

Much of the hostility that once existed between the Punjabi Sikhs, central government and the Congress Party has evaporated—partly because, in Manmohan Singh, the country now has its first Sikh prime minister. But as with Gujarat, reconciliation depends upon truth and justice in addition to the mere passing of time.

Ian Taylor
Farnham Common, Buckinghamshire

Who's like Chávez?

SIR – I agree that Venezuela's president, Hugo Chávez, is unsuitable for office ("The case against Hugo Chávez", August 14th). He has divided Venezuelans along the lines of "partisanship and confrontation" and has attempted to politicise the legal system of his country by "packing the judiciary with loyalists". I await with great eagerness your editorial closer to America's election denouncing George Bush for committing these same sins in the United States.

James Currie
Alexandria, Virginia

SIR – While Venezuela's experiment in social democracy will eventually need to move right for longer-term success, I would suggest that its free press, investment in education and health-care, and its endorsement of the democratic process may not be such a bad beginning. Unfortunately, Mr Chávez's excess spending of oil profits is not unusual for oil-rich countries nor is his leverage of incumbent political power during a re-election campaign. Regardless of the outcome, the good news is that the constitution has been successfully contested. This is the necessary first step for a legitimate and enduring democracy—especially one that needs to continue exporting its vast oil wealth to the rest of the world.

Bill Hory
Manhattan Beach, California

Adding value

SIR – As a learned society that represents British research mathematics, we know what effect a switch to a purely "author-pays" model of scientific publishing would have on the intellectual activity which we foster ("Access all areas", August 7th). Being good at sums, we have "done the maths". Publishing is the biggest source of our income, the great majority of which is fed back to support mathematics in Britain and overseas through grants and meetings. Without that income a large part of this country's research

and communication in the field of mathematics would cease.

Susan Hezlet
London Mathematical Society
London

Courting gum owners

SIR – You say that John Kerry has “embraced targets” with no “teeth” (“A trio of surprises”, August 14th). Is this a variation of the old practice of politicians kissing babies?

Robert Tyrrell
Bettona, Italy

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George Bush

The contradictory conservative

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From The Economist print edition

Despite the narrowness of his mandate, George Bush has done more to alter America's profile abroad, and its government at home, than any president in years

NEXT weekend, the Republicans, meeting in New York, will anoint George Bush as their candidate for a second term. His approval ratings in his own party stand at around 86%. Among Democrats, they run at around 8%. Few presidents have been loved and loathed as heartily as Mr Bush; few have so starkly polarised the country; and few have done so much to change both the way America's government behaves at home, and the way it is perceived abroad.

The Bush presidency has proved a radical unsettling force, from AIDS policy in Africa to education reform at home; in different ways, for good and ill, it has undermined the rulers of both Saudi Arabia and San Francisco. Rather than offering a compendium of all that Mr Bush has achieved, this special report will focus on three projects that history may eventually judge the most controversial: the alleged “revolution” in foreign policy, the pursuit of big-government conservatism and the dramatic expansion of presidential powers. These may not prove the deciding factors in the coming election; but they may be the ones that resonate longest.

Begin with foreign policy. Mr Bush has had a bigger impact on diplomacy than any president since Harry Truman. After the second world war, Truman set up the system of alliances that ensured the Soviet threat would be contained and American leadership of the West would continue after Europe recovered. Ronald Reagan turned Truman's creation into more of a public challenge to what the Soviet Union stood for, but he did not fundamentally alter its structure.

Mr Bush did. After the end of the cold war—long after, in fact—he argued that the old world order had run its course. He rejected both a supposed cornerstone—the Anti-Ballistic Missile (ABM) treaty—and some later additions, such as the Kyoto accords and the International Criminal Court, both also rejected by Congress.

But Mr Bush's foreign-policy revolution actually came in two steps. The rejection of the treaties was the first and, since it came to terms with a geopolitical fact, the Soviet collapse, it may well prove the more lasting. The second step came only after the September 11th attacks, with the wars in Afghanistan and Iraq. In response to the atrocity, NATO for the first time invoked its article 5 provision that an attack on one member is an attack on all, signalling a willingness to help America militarily. The Bush administration was slow to pick up the offer. “Coalitions of the willing” took the place of traditional

alliances. Then, in Iraq, Mr Bush put his doctrine of prevention and possible pre-emption into effect. In an age of global terror, this said, self-defence meant acting alone and pre-emptively, if need be. Working through the United Nations—ie, waiting for others—could be suicide.

These two steps obviously had much in common. Both said that treaties can constrain America's freedom of action and that, when they do, they should be ignored. Both imply that the exercise of power alone may be enough to achieve American aims. Still, the second step went beyond the first. It proposed new rules for going to war and a substitute for traditional alliances—the willing coalitions.

Over the past few weeks, however, these additions have begun to look shaky. Is the Bush revolution in foreign affairs reaching its limits?

It may be. In May 2003, on the flight-deck of the *USS Abraham Lincoln*, Mr Bush argued that once upon a time, “military power was used to end a regime by breaking a nation. Today we have the greater power to free a nation by breaking a dangerous and aggressive regime.” Experience in Iraq contradicts that optimism, or at least suggests that “freeing a nation” requires more than just bringing down a troublesome regime. Legitimacy, it turns out, matters. It does not spring up spontaneously if American motives are pure, as some in the administration have argued. And coalitions of the willing do little to confer legitimacy.

Moreover, as Ivo Daalder of the Brookings Institution and Jim Lindsay of the Council on Foreign Relations have argued, the doctrine of pre-emption supposes that the intelligence services will be good enough to warn America of threats before they are realised. The catalogue of errors is not reassuring on this point.

Lastly, problems in Iraq have strained the unstable coalition that is Mr Bush's foreign-policy team. Neo-conservatives, who argue that America's destiny is to spread democracy round the world, are losing influence. The world-view of assertive nationalists (notably Dick Cheney, the vice-president, and Donald Rumsfeld, the secretary of defence), who say military might will be enough to deter America's enemies, has not been dethroned. But it has been weakened, and their unilateralist instincts look more problematic. The “soft power” diplomats—Colin Powell and the State Department—have become more important. All this raises questions about support for Mr Bush's foreign policy even within his own cabinet.

As if to confirm the doubts, the past few months have seen a new look. Having handed over sovereignty to the Iraqis and got the Security Council's blessing, as it always meant to, America has also asked Europeans to endorse its “Broader Middle East Initiative” and appealed to NATO to help train Iraqi troops. The big question now is whether these changes are part of a profound reappraisal of American foreign policy, or whether they are just tactical adjustments to recent difficulties.

The honest answer is that it is too early to be sure. But the changes are probably tactical. Despite the presence of heavyweights in his cabinet, Mr Bush has always been the author of America's foreign-policy transformation, and he has repeatedly denied any new change of course. This is not to be discounted; in foreign affairs, the president has usually signalled what he is planning to do very clearly.

It is true that Iraq has raised doubts about the doctrine of prevention and pre-emption. But the debate has shown that the alternative “rules for going to war” are, from America's viewpoint, far worse. This is the claim, particularly espoused by France and Germany, that, except in the case of actual attack or imminent threat, countries cannot use military force legitimately without the approval of the Security Council. No American president would ever accept, or has ever accepted, such an idea. If others insist that the alternative to unilateralism is the UN, America will stick with unilateralism.

Most important, the underlying rationale of Mr Bush's transformed policy has not really changed. This is that there is a huge gap in military power between America and everyone else, that the country has opportunities denied to anyone else and that traditional alliances are therefore useful rather than necessary. Iraq has shown that the exercise of American power is harder than the administration thought; but the exercise of power is still what matters most to Mr Bush. In that sense, his foreign policy is being refined, not retooled.

Mr Bush once campaigned as a proponent of a “humble” foreign policy. In practice, he has not provided one. On the domestic front, he has been equally surprising. And despite the narrowness of his mandate, he has proved as polarising at home as he is abroad. Consider, next, the peculiar character of the president's domestic conservatism.

A big-government guy

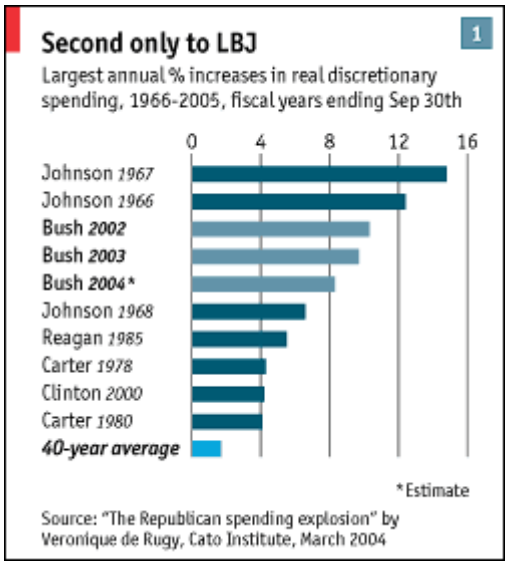
This is one of the most conservative politicians ever to inhabit the White House. Mr Bush has fed red meat to the various groups that make up the conservative coalition—opposition to abortion, gay marriage and stem-cell research for social conservatives; the invasion of Iraq for neo-conservatives; tax-breaks and deregulation for business conservatives. He has driven liberals stark raving bonkers. “Among the worst presidents in US history,” proclaimed Jonathan Chait in the *New Republic*. “Incomparably more dangerous than Reagan or any other president in this nation's history,” wrote Harold Meyerson in the *American Prospect*.

But exactly what sort of conservative is Mr Bush? Ever since Barry Goldwater's quixotic bid for the White House in 1964, American conservatism has been a small-government philosophy. Ronald Reagan regarded government as the problem rather than the solution, and therefore shrank social programmes. Newt Gingrich's troops assaulted not just Lyndon Johnson's Great Society but also a pillar of FDR's New Deal, the welfare system.

Mr Bush's track-record has been very different. While cutting taxes in a dramatic way that Mr Reagan would surely have applauded, he has relentlessly expanded both the scale and scope of central government—in order to advance the conservative cause. Mr Bush has tried to preside over the birth of a new political philosophy: big-government conservatism.

The Bush presidency has seen the biggest increase in discretionary spending since his fellow Texan, Johnson, was in the White House (see chart 1). In his first term, according to the 2005 budget, total federal spending will rise by 29%, more than triple the rate of increase in Bill Clinton's second term. The Bush administration raised spending on education from $36 billion in 2001 to $63 billion in 2004, a 75% increase; it has also pushed through the biggest expansion of Medicare, the federal health-care plan for the old, since the programme was created in the 1960s. More people now work for the federal government than at any time in history.

It could be argued that the expansion of government under Mr Bush is the unfortunate consequence of events, particularly the September 11th attacks. The terrorist threat more or less forced the government to create a giant new homeland-security apparatus, which Mr Bush at first opposed. Mr Bush has promised conservatives that he will try to get spending under control; the 2005 budget envisions domestic discretionary spending rising by only 0.5% and calls for the abolition of 65 federal programmes, saving $4.9 billion.



Not just homeland security

Yet this argument seems unconvincing. The war on terror accounts for only part of the increase in government spending. As for Mr Bush's promise that he will eventually get spending under control, the White House has already embraced commitments that could keep government growing for years. On some estimates, the Medicare bill alone could end up costing $2 trillion in its second decade.

Mr Bush's big-government conservatism goes beyond a mere blind response to events. During the 2000 campaign, he made it clear that he had a different attitude to government from his fellow conservatives. He sang the praises of “focused, effective and energetic government”. Rather than calling for the abolition of the Department of Education, like the rest of his fellow conservatives, he called for its expansion. He even had a good word to say about Johnson's Great Society.

Mr Bush's big-government conservatism also goes beyond a mere willingness to spend public money. He

has reversed a long-standing Republican commitment to decentralisation by giving the federal government a greater role in setting education standards than it has ever had before. He has also reversed a long-standing Republican suspicion of government bossiness by trying to use government to promote conservative values. The Education Department is promoting abstinence in sex education. The Department of Health and Human Services is trying to use the welfare system to advocate the virtues of marriage and responsible fatherhood. John Ashcroft's Justice Department has ridden over states' rights to prosecute people who believe in assisted suicide and the medical use of marijuana.

Where has all this come from? Mr Bush turned to big-government conservatism as an antidote to growing problems of the small-government kind. As the 1990s wore on, Mr Gingrich and his merry band increasingly tried America's patience with their bomb-throwing radicalism. The middle classes had been happy to advocate tough love for the poor, but they were much less happy when the tough love involved cuts to Medicare or student loans. Not unfairly, Mr Bush calculated that making peace with government was the only way to re-endear conservatism to the middle class.

Many of his fervent supporters regarded tax cuts as their highest priority: cuts that Mr Bush duly delivered. But many elements in the conservative coalition also looked to government to solve their problems. Business people wanted the government to subsidise their industries at home and promote their interests abroad. Corporate America had been calling for educational reform for years. Social conservatives were keen on using government to promote “virtue” or eradicate “vice” (from assisted suicide to pot-smoking), a position highly attractive to a president who starts every cabinet meeting with a prayer. The White House and the Republican majority in Congress worked assiduously to shower government largesse on Republican-leaning interest groups. Agricultural legislation involved a huge give-away to agribusiness; prescription-drugs legislation provided a bonanza for the pharmaceutical industry.

The neo-conservative intelligentsia has played as vital a role in promoting big-government conservatism as it did in promoting the Iraq war. Irving Kristol, the godfather of neo-conservatism, sees the growth of the state as “natural, indeed inevitable”. His son Bill uses his *Weekly Standard* magazine to lead a crusade to replace “leave-us-alone conservatism” with “national-greatness conservatism”. Mr Kristol and his supporters argue that “wishing to be left alone isn't a governing doctrine”, and that loving your country while hating its government is not a sustainable philosophical position. Besides, there is no need to hate government if it is in the right (Republican) hands.

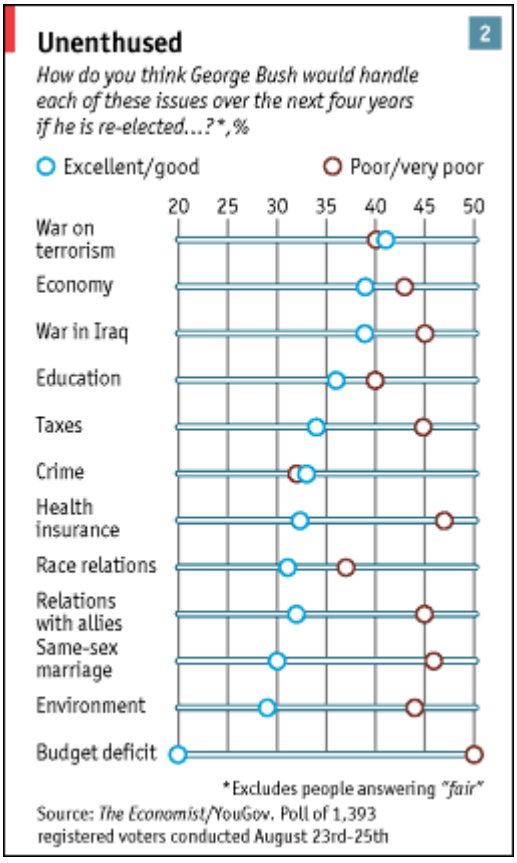
A lasting philosophy?

The most compelling argument in favour of Mr Bush's policies is that he is doing more than just expanding government. He is increasingly tying public spending to competition and accountability. The No Child Left Behind Act, the most interesting reform of American education for a generation, uses a combination of national standards and standardised testing to measure children's progress: if too many children in a particular school fail to hit the required standards, then parents have the right to move them elsewhere. The Medicare reforms have been a way of introducing medical savings accounts. The proposed individual investment accounts in Social Security (federal pensions) will give individuals more responsibility for managing their nest eggs. This emphasis on accountability explains why public-sector unions loathe Mr Bush, despite his big-spending ways.

Yet attempts to introduce competition in schools or health care have not gone very far. There are good reasons to doubt whether the educational bureaucracy will ever have the guts to close down failing schools. The Bush administration signally failed to use the expansion of Medicare as a lever for introducing structural reforms, such as means-testing. Mr Bush's only real chance to build choice into the heart of a government programme lies in his mooted Social Security reforms.

Even if these programmes can be made to work, big-government conservatism undoubtedly has drawbacks. The new creed's biggest problem is simple: if you cut taxes deeply while increasing spending lavishly, you end up with a gigantic deficit. This newspaper is not about to argue that cutting taxes is wrong in principle: the Republican Party's instinct that it is better to leave money in voters' pockets than to give it to bureaucrats has been one of its most attractive features. But big, persistent budget

deficits also put a burden on people. If the Republicans continue to tax like a small-government party and spend like a big-government one, deficits could average $500 billion a year for the next decade—an alarming prospect. Mr Bush should be preparing for the retirement of the huge baby-boomer generation.



Nor is big-government conservatism the political cure-all that it might seem. It is alienating big chunks of the Republican coalition. Libertarians don't want to be told whether they can smoke pot by Mr Ashcroft. Old-fashioned conservatives don't want to see Washington extending its power over local schools. And good-government types don't want to see the deficit balloon out of control.

Senator John McCain has reprimanded Mr Bush for failing to use his veto to control a Congress which is spending money "like a drunken sailor". Rush Limbaugh has complained that Mr Bush's legacy may be the greatest increase in domestic spending, and one of the greatest setbacks to liberty, in modern times. "This may be compassionate", says Mr Limbaugh, "but it is not conservatism at all."

A third problem lies with unintended consequences. Forty years ago, the founding fathers of neo-conservatism criticised the Great Society on the grounds that its soaring intentions often produced bad results: rent control reduces the availability of affordable housing, for example. The biggest unintended consequence of Mr Bush's efforts may be that big-government conservatism morphs into big-government liberalism. Government is by its nature a knife that cuts to the left, in part because government employees tend to be on the left, in part because government programmes promote dependency. Rather than twisting government to conservative ends, the Republicans may simply be creating yet more ammunition for future Democratic administrations.

Mr Bush is nothing if not ambitious. If his new philosophy endures, he will be a transformative figure in the history of the modern conservative movement. If it fails, he will be seen as a domestic policymaker who doomed himself by ignoring the central insight of the revolution that began with Goldwater: that the essence of conservatism lies in shrinking government.

Mr Bush's presidency has been radical not only in what he has tried to do, but in the way he has gone about doing it. His term has seen an extraordinary change in style. Partly by his own efforts, partly as a result of underlying forces, he has increased the power of the presidency at the expense of other branches of government. This is the third great project of his presidency, the least noticed outside Washington, DC, and perhaps the most worrying.

Imperium revisited

Mr Bush came to office arguing that restrictions on presidential authority, especially since Watergate, had harmed decision-making. The implication is that good government requires a certain period of privacy in which officials can thrash out policies. The public should judge only the result. In 2002, his vice-president, Dick Cheney, said, "I have repeatedly seen an erosion of the powers and the ability of the president of the United States to do his job." He said he and Mr Bush had talked about the need to "pass on our offices in better shape than we found them to our successors." They have succeeded, after a fashion, but at a heavy cost.

Unified government, with the administration and Congress under the same party's control, tends to boost presidential authority anyway—the more so this time, as the Republican Party is fairly disciplined. Tom DeLay, the majority leader in the House of Representatives, has defined his job simply: "How do I advance the president's agenda?" The party's narrow majority keeps troops in line. Lest there be any backsliding, Mr Bush's personal campaigning in the 2002 mid-term elections reminded congressmen and senators of their interest in keeping on good terms with him.

More important, wars always increase the powers of the executive branch. Because it has implications for

America's domestic freedoms, the war on terror may well end up increasing executive power more than most.

But Mr Bush's ambitions have gone beyond what these underlying forces make inevitable. One measure of his ambition was the claim of the Office of Legal Counsel in the Justice Department (the administration's main source of legal advice), made in August 2002, that the president's authority as commander-in-chief was in effect unlimited in the conduct of a war. As the legal opinion put it, he "enjoys complete discretion in the exercise of his commander-in-chief authority."

This claim showed how expansive Mr Bush's view of his powers could be. No former president had gone that far. In fact, it was too far. The Supreme Court said the constitution did not warrant such a reading and struck down the policy based on it: holding detainees from the war in Afghanistan without charge. But the case was unusual only in that the high court overruled Mr Bush. More commonly, he has had his way.

The most important check on a president's authority is Congress, formally the sovereign power. To see how Mr Bush and his allies have treated the legislature, consider the Medicare bill.

In January 2003, the White House sent Congress a proposal for reform of the health-care system. The price tag, it said, was $400 billion. The real cost was $534 billion. Medicare's chief actuary was told not to answer congressional questions on pain of dismissal. After the House and Senate passed different versions of the proposal, the Republicans began work to reconcile the two. They refused to let five of the Democrats nominated to the process take part in deliberations—and rewrote the bill.

Even then, they fell short of a majority when voting began, at 3am. Defying precedent, the House leadership held the vote open for three hours while arms were twisted. The bill finally passed just before 6am. Norm Ornstein, of the conservative American Enterprise Institute, called it the ugliest breach of congressional standards in modern history.

Making laws has always been like making sausages (don't look closely). When the Democrats were in charge, they did not always run Congress as prescribed in the civics textbooks. Some of Congress's hallowed traditions could do with pruning, especially the power of committees.

But the Republicans have put forward none of this in mitigation. Instead, they have claimed, in essence, that the ends justify the means. Mr Bush, they say, has pushed big tax cuts and education and health-care reforms through a closely divided, bitterly partisan institution. The alternative to such strong-arm tactics was legislative gridlock, which, they argue, would have been worse.

Even if you think the ends are good, the means have inflicted institutional harm on Congress. The committee system for amending bills has all but collapsed. Bills are now written by the leaders and their staffs, in concert with the White House. Debate is often cut off: many controversial measures are voted on under a "closed rule", which bars amendments. The conference stage, when different versions of a bill are reconciled, has been turned from an occasion for compromise into yet another opportunity for partisan gain. Sometimes the conference committee does not meet at all. Sometimes Republicans have ignored the rule that says the committee can only iron out differences, and have fundamentally altered bills at the last minute. The budget process is in tatters.

Dozing watchdogs

As for Congress's other main job—oversight of the administration—that has declined too, with a few exceptions (the Senate Armed Services Committee held useful hearings on the Abu Ghraib scandal). Serious investigation has been left to special commissions, such as the one that looked into the September 11th attacks. The responsibility for this lies largely with congressional Republicans: they are reluctant to investigate one of their own. But Mr Bush has not exactly shown deference to Congress's oversight role. The White House refused to let Tom Ridge, the head of homeland security, testify in 2002. It declared it would not answer questions from Democrats on budget committees. Mr Bush refused to testify before the 9/11 commission. In all these cases, the administration finally backed down. But at a time of dramatic change, the watchdogs of Congress have been dozing.

Congressional oversight is at the heart of the administration's claim that excessive intrusiveness is harming executive decision-making. The *cause célèbre* in this case was the new energy policy. When Democrats attempted to force the vice-president to reveal whom he had met while formulating an energy

bill, Mr Cheney refused, arguing that the constitution protects the president and vice-president from congressional attempts to reveal details of their deliberations. As the solicitor-general argued to the Supreme Court, “Congress may neither intrude on the president's ability to perform these [deliberative] functions, nor authorise private litigants to use the court to do so.” On this occasion, Mr Cheney prevailed. His victory will encourage future administrations.

But the administration has not stopped there. The power of the president is limited not only by the might of Congress but by a host of smaller laws and administrative rules: freedom-of-information requests, the power to classify documents, and civil-service procedures. Partly in response to domestic security worries, the discretionary power of the executive has increased substantially in these areas.

The best-known examples come from the Patriot Act, which boosted law-enforcement powers and surveillance. That act, at least, was passed by Congress and is subject to congressional review. More commonly, the administration has increased its powers by asserting them. Soon after September 11th, Mr Ashcroft issued new guidelines on freedom-of-information requests. The attorney-general reversed the Clinton-era policy of rejecting such requests only if to allow them would cause “substantial harm”. Public-interest groups complain that requests are now often denied, even over matters that seem to have nothing to do with security, such as pollution or car safety.

According to figures from the National Archives, around 44m documents were classified in the first two years of the current administration—as many as in the whole of Mr Clinton's second term. More officials—including, for some reason, the secretary of agriculture—have been given the power to classify materials. This is more than just a response to September 11th. Mr Bush has issued an executive order overturning the rule that presidential papers are automatically declassified 12 years after presidents leave office; instead, he said, former presidents could decide whether to disclose their papers during their lifetimes, and the incumbent president would also have power of review.

In the details

A subset of this reaction against scrutiny is the use of what might be called government by small print: slipping additions into law at the last minute or tinkering with the wording of rules that implement laws. As a recent series in the *Washington Post* argued, such changes often appear minor but can have a big impact. By changing the word “waste” to “fill” in a rule governing coal-mining, for instance, the administration allowed an increase in strip-mining in West Virginia. By adding two sentences about scientific evidence to an unrelated budget bill, it gave itself increased authority to rule in regulatory disputes.

Perhaps the most disturbing way in which the administration has increased its power has been through its public-relations machine. Thomas Jefferson said long ago that a well-informed electorate is the most important constraint on government. By issuing partial and sometimes misleading information, the Bush administration has hampered such scrutiny.

Consider for instance the arguments for tax cuts. Here, Mr Bush made claims about the cost of the cuts and their distributional impact that he should have known were misleading. In 2000, he claimed the first round of cuts would cost $1.6 trillion over ten years, a quarter of the budget surplus at that point. On his own figures, the share was a third, not a quarter, and he arrived at the figure only through outrageous accounting gimmicks that he is now campaigning to forbid.

He also asserted that the cuts would provide “the greatest help for those most in need”, providing a Treasury study to back up his claim. In the past, Treasury studies have been impartial. But this one arrived at its conclusion by leaving out the parts of the tax cut that most benefited the wealthiest (such as the repeal of the estate tax). By any normal measure, the tax cuts have been regressive—hardly “the greatest help for those most in need”.

Taking facts out of context, politicising government studies and presenting anomalous examples as typical are hardly unique to the Bush administration. But they still do damage. The system of checks and balances—indeed, democracy itself—requires voters to be able to understand the impact of actions taken on their behalf, so they can apportion credit or blame fairly. If it is impossible to tell how much of the administration's arguments for war were vindicated or disproved, or who the tax cuts really helped, then proper public accounting is impossible.

Beyond that, members of the administration have occasionally acted in ways that have discouraged

public debate directly. In May 2002, the White House's communications director, Dan Bartlett, argued in the *Washington Post* that Democratic criticisms of administration actions before September 11th were "exactly what our opponents, our enemies, want us to do." Mr Ashcroft had earlier conflated civil-liberties activists with terrorist sympathisers, telling Congress: "To those who scare peace-loving people with phantoms of lost liberty, my message is this: your tactics only aid terrorists." All this came near to arguing that, after September 11th, debate itself could be treasonous.

Mr Bush has frequently said that voters will give their verdict in November, and that he looks forward to it. But quadrennial elections are not the only means of restraining government. The genius of the American system is that administrations must work within a system of checks and balances. These checks have themselves been checked.

Congress is the main competing source of power. It has become more like an adjunct to the administration. Information encourages public scrutiny. The flow has been reduced. The administration's actions are filtered through civil-service rules and procedures. The rules have been chopped and changed. A free press is essential to the working of democracy. Andy Card, the White House chief of staff, rejected that view, arguing "I don't believe you [the press] have a check-and-balance function." On occasion, the administration has even crossed the line separating the interests of the state from the party by using taxpayers' money to finance advertising for the Medicare bill.

Almost all governments bend the truth. This one has seldom resorted to outright falsehood; instead, the administration has manipulated public information and breached basic standards of political conduct in Congress, the civil service and public debate. Whatever the merits of increasing presidential authority, Mr Bush has achieved his aim less by winning support for more power than by weakening the authority of other institutions.

In the round

Mr Bush's supporters may regard carping on about this expansion of powers as a distraction from other more visible achievements of his presidency. Look, they may argue, at the way that the White House has set about reducing nuclear proliferation, or at his plans to build an ownership society at home, or at the long-term economic stimulus of his tax reform. From the other side, his critics complain that the administration has trashed the environment, or worsened inequality, or schemed to roll back abortion rights.

It usually takes some time for the true significance of any presidency to emerge. Mr Bush's most contentious projects may come to seem relatively unimportant. For now, perhaps the most remarkable thing about this presidency is the extent to which it has already confounded expectations. When Mr Bush was elected, it was widely believed that his power would be slight and he would achieve little. For better or worse, those predictions were refuted. Whether this will help or harm him in November remains to be seen.

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The laws of war

Trials and tribulations

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AFP

A busy week for Donald Rumsfeld: exoneration of a sort for the torture at Abu Ghraib; and the first military tribunals go to work at Guantánamo Bay

FOR the past few months the image of American justice around the world has been dominated by two sets of prisoners: those at Abu Ghraib, the notorious Iraqi jail where detainees have been subjected to wretched abuses; and those orange boiler-suited “enemy combatants” held indefinitely without charge at Guantánamo Bay. Both fall within the bailiwick of Donald Rumsfeld. This week, the defence secretary could claim to have made a little progress on both counts.

The treatment of Iraqi prisoners at Abu Ghraib is the subject of two new reports. It will come as no great surprise to Mr Rumsfeld's critics that both investigations were headed by men the Pentagon had appointed; and that both absolve the defence secretary and other senior Pentagon officials of direct responsibility for the abuses, heaping most of the blame on a relatively small group of soldiers and intelligence officers. There was no policy of abuse, the reports agree, and no attempt to extract information by torture. Yet the reports do not entirely let Mr Rumsfeld off the hook.

One report, an internal army inquiry into intelligence activities at Abu Ghraib headed by Major-General George Fay, blames the abuse on “a small group of morally corrupt soldiers and civilians”. It found 27 military intelligence personnel who allegedly “requested, encouraged, condoned or solicited military police personnel to abuse detainees and/or participated in detainee abuse” or otherwise violated interrogation procedures.

Interestingly, Major-General Fay found “no policy, directive or doctrine (that) directly or indirectly caused violent or sexual abuse”. This seems to contradict a previous report by another general, Antonio Taguba, which concluded that there were “systemic” problems at Abu Ghraib. However, Major-General Fay does not let the higher-ups off completely: One member of his panel bluntly told reporters: “there were leaders who knew about this misconduct, knew better, and did nothing.”

Something of the same nuanced judgment emerges from the independent panel headed James Schlesinger, a widely respected former defence secretary. He likewise attributes the worst abuse, as depicted in the Abu Ghraib photographs, to unauthorised “freelance” activities by soldiers on the prison's night shift. And he specifically argues that sacking Mr Rumsfeld would help America's enemies.

Nevertheless, neither Mr Rumsfeld nor the generals have been exonerated. Mr Schlesinger criticises the

Pentagon for not being clear about what sorts of interrogation techniques were allowed. He complains that Mr Rumsfeld himself did not react quickly enough when the insurgency erupted in the summer of 2003. The top brass, including Lieutenant-General Ricardo Sanchez, the commander of American operations in Iraq, delayed for too long sending prison guards to Abu Ghraib to deal with the swelling number of prisoners. Those running Abu Ghraib, the report says, were not adequately trained or equipped to deal with the chaos.

Both Mr Schlesinger and Major-General Fay blame the abuse on the confusion following the fall of Saddam Hussein's regime. The prison was under constant shelling; Iraqi policemen were slipping arms to prisoners; and the detainees outnumbered the guards by 75 to one.

This is not likely to satisfy critics. Nor is the lack of evidence directly linking Mr Rumsfeld to the abuses. Many of those who called for the defence secretary to go did so on the basis that the man in charge should do so as a point of honour for the good of America's reputation; and also because his various inflammatory statements and aggressive policies towards detainees in the war on terror had created a culture where such abuse was more likely.

Interestingly, the Schlesinger panel makes 14 recommendations on how to avoid further brutalities. In particular, it calls for a clearer definition of the status of people captured in American military operations—which provides another link between the Iraqis at Abu Ghraib and the terrorist suspects at Guantánamo Bay whom Mr Rumsfeld has decided to designate as “illegal enemy combatants”.

“There were leaders who knew about this misconduct, knew better, and did nothing”

Controversially, these prisoners, mainly caught in Afghanistan, have none of the rights or protections under the Geneva conventions. Earlier this month, the American Bar Association condemned “the widespread pattern of abusive detention methods... [which] feed terrorism by painting the US as an arrogant nation above the law”. The more polite Mr Schlesinger urges the government to “update” its approach to international humanitarian law, taking particular heed of the case for “reciprocity and the preservation of US societal values and the international image that flows from an adherence to recognised humanitarian standards”.

To be fair to the administration, it has recently introduced a series of measures to improve detainees' conditions. This week, military commissions began the preliminary hearings in the trials of the first four Guantánamo Bay detainees, two-and-a-half years after the first terrorist suspects arrived. President Bush hopes this will help to satisfy the Supreme Court, which ruled in June that the detainees, until now plunged into what has been described as a legal black hole, have a right to challenge their detention in the American courts.

The Pentagon insists the tribunals, the first to be set up since the end of the second world war, will give the detainees “full and fair” trials in accordance with international standards of justice. This includes a presumption of innocence, representation by a lawyer of their own choice as well as a military lawyer, the requirement of proof of guilt beyond reasonable doubt, the ability to call their own witnesses as well as to cross-examine those called by the prosecution, and the right of appeal to a review panel of professional judges.

Yet the military lawyers appointed to defend the detainees do not see the tribunals as fair at all. They criticise the lack of a right of appeal to an independent civilian court. They have already questioned the impartiality of the judges and they are concerned that information extracted under duress will be used in evidence. Besides, they ask, how can any of the detainees get a fair trial when they have already been collectively branded by Mr Bush and Mr Rumsfeld as “killers”, “bad men” and “well-organised, dangerous terrorists”?

The military lawyers are already protesting some of these points in the hearings. More broadly, human-rights groups worry whether Mr Rumsfeld has any intention of releasing people he deems a threat to the United States or capable of providing useful information in the war on terror, even if they are found innocent. As long as so many of Guantánamo's 600-odd prisoners seem stuck there indefinitely, the fuss will continue.

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The CIA

For the scrap-heap?

Aug 26th 2004 | WASHINGTON, DC
From The Economist print edition

A startling new proposal for bucking up America's intelligence services

Get article background

THE Central Intelligence Agency has been humiliated lately by a welter of critical reports. Now its very survival has been questioned. On August 23rd, Pat Roberts, the Republican chairman of the Senate Intelligence Committee, outlined legislation to forge America's disparate intelligence agencies into a new National Intelligence Service.

The service would be run by a hugely powerful director, backed by four assistant directors, each responsible for a different phase of the intelligence process. The CIA would be dismantled, and its departments assigned to the relevant assistant director. Control over other intelligence agencies would be wrested from the Defence Department and the FBI.

Mr Roberts's bill, the most radical of several recent plans to reform the intelligence community, stems from failures highlighted by his own committee in a report on the pre-war intelligence on Iraq. That report found America's agencies generally loth to share intelligence and the CIA especially incompetent.

But would Mr Roberts's plan really fix these problems? Spooks are no keener on change than other bureaucrats are. But they insist Mr Roberts's priorities are wrong.

According to one former spy, the agency first needs to recruit more diversely, work with foreign agencies more readily and return to the first principles of human intelligence-gathering. The CIA had not a single reliable agent in Iraq. No degree of restructuring would have fixed that problem.

Urging caution, Michael O'Hanlon of the Brookings Institution argues that the intelligence failure on Iraq was not the CIA's alone. Like every other western intelligence service, the agency wrongly concluded that Iraq had retained its weapons of mass destruction. And many of the fire-walls between the CIA and other agencies that helped make this error possible have since been broken down. But the CIA also rightly concluded that Iraq had at most only a slender link to al-Qaeda, even though that alleged link was a key part of the Bush administration's case for war. “The CIA is not as broken as Mr Roberts alleges,” says Mr O'Hanlon.

In political terms, the timing of Mr Roberts's prescription for the CIA does seem a trifle iffy. His committee is due to embark on a second phase of investigation, into whether the pre-war Iraq intelligence was manipulated by the administration. But it will not release that report until after the election.

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Vietnam and the presidency

Was he really under fire?

Aug 26th 2004 | WASHINGTON, DC
From The Economist print edition

John Kerry's war record gets shot at

Get article background

FOR NEARLY four months in late 1968 and early 1969, when he was serving with the American navy, John Kerry commanded a Patrol Craft Fast (PCF), or “Swift Boat” as the sailors called it, in the waterways of the Mekong Delta, which were used as supply lines by the Vietcong. He was awarded a Silver Star and a Bronze Star for bravery, and three Purple Hearts, a medal American servicemen get when they are wounded. But now the events of more than 35 years ago have come under question, and it is the presidential candidate who went to Vietnam, not the one who managed to stay at home, who is on the defensive over his war record.

A group called Swift Boat Veterans for Truth has put out an advertisement in three closely contested states—Ohio, West Virginia and Wisconsin—which accuses Mr Kerry of lying to win his medals. A leader of the group, John O'Neill, has written a book, “Unfit for Command”, which describes Mr Kerry as a bungler in combat. Backed by more than 250 others who served in Vietnam, the group has just unveiled a new ad, denouncing Mr Kerry's testimony about the war in 1971 before the Senate Foreign Relations Committee. What he said then, they claim, cast all Vietnam veterans as war criminals and demoralised American prisoners-of-war.

It is a sharp blow to Mr Kerry. A majority of Americans have heard the accusations, and opinion polls show that many of them find the charges to some degree believable. Support for Mr Kerry among ex-servicemen has collapsed.

The Kerry camp is now counter-attacking. It says that the Swift Boat group is a front for George Bush's campaign, charged with doing its “dirty work”. A Bush-Cheney lawyer, who gave advice to the group, has now resigned. One of the vets in the ad was also once an adviser to the Bush campaign. Mr Kerry has made a complaint to the Federal Election Commission, accusing Mr Bush of breaking the law, because propaganda groups such as the Swift Boat lot are “527 organisations” (so called from a clause in the tax law), which are legally required to be independent. Mr Bush has denied any connection with the group. He himself has been bitten by other, left-leaning 527 organisations; one has compared him to Hitler.

What do the people who were in the Mekong Delta at the time say? On the one hand, all but one of Mr Kerry's crewmates from the two Swift Boats he commanded in Vietnam have rallied to his side. On the other hand, a group of veterans from the unit of which these boats were a part, many of whom behaved bravely in action, have made serious charges against him.

One test case is Mr Kerry's account of rescuing Jim Rassmann, a Green Beret commando, the action which earned him his Bronze Star. Everyone agrees that on March 13th 1969 Mr Kerry's Swift Boat, PCF-94, and four others were travelling down the Bay Hap river when one of them hit a mine. Soon afterwards, according to Mr Kerry's crew, an explosion rocked PCF-94, throwing Mr Rassmann overboard. An injured Mr Kerry fished him out of the river in spite of the bullets flying about them. Mr Kerry's crew say they were under attack. Mr Rassmann himself says he was “scared to death”, and saw bullets splashing in the water around him. A machine-gunner from the boat directly behind Mr Kerry's also recalls enemy fire.

But Larry Thurlow, the captain of another boat, denies that they were under enemy fire. The other two surviving Swift Boat captains who were there also do not recall being fired on. Worse, Mr Thurlow says that Mr Kerry's boat fled from the scene after the mine exploded, turning back to go to the aid of the disabled boat only when its captain was certain there was no danger. He claims that Mr Kerry fabricated

the hostile fire in an after-action report which became the basis of Mr Kerry's and his own Bronze Stars. It is unlikely, however, that Mr Kerry wrote the after-action report. The author used the initials “KJW”; Mr Kerry's are “JFK”.

Then there is the question of Mr Kerry's Silver Star. The accusers say he exaggerated his role in a three-boat operation on February 28th 1969. William Rood, the only other surviving boat captain on the operation, has defended him. Writing in the *Chicago Tribune* on August 22nd, Mr Rood said it was Mr Kerry who had the idea of charging headlong into an ambush on the banks of the Bay Hap river, thereby routing the enemy and capturing large numbers of weapons. Then Mr Kerry beached his boat while under enemy fire in order to chase and kill a Vietcong soldier and seize a loaded rocket-launcher. Mr Rood's account conflicts with Mr O'Neill's claim that Mr Kerry killed a “lone, wounded, fleeing, young Vietcong” who may not have been armed.

It is the presidential candidate who went to Vietnam, not the one who managed to stay at home, who is on the defensive over his war record

On the issue of Mr Kerry's Purple Hearts, the Swift Boat Veterans have a point. It is true that none of his injuries was severe, and that he used them to cut a one-year tour of duty down to little over four months: three Purple Hearts earn leave from active duty. But the claims that Mr Kerry's wounds were either self-inflicted, or mere scratches, do not seem to be based on really solid evidence.

The two things that seem likely to cause Mr Kerry most trouble are not disputes about his courage. The first is his repeated claim that he entered Cambodia on Christmas Eve 1968. This now looks dubious. The Kerry camp has backed away from the assertion, saying that he merely patrolled the Mekong Delta near the Cambodian border. His other weakness is that testimony before the Senate Foreign Relations Committee in 1971. Mr Kerry spoke of American soldiers who “razed villages in a fashion reminiscent of Genghis Khan”. He may yet rue deciding to make Vietnam so big a part of his presidential campaign.

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The electoral week

On the trail

Aug 26th 2004
From The Economist print edition

Giving him the boot

“Iraq as a team does not want Mr Bush to use us for the presidential campaign. He can find another way to advertise himself.”

Salih Sadir, a midfielder in the Iraqi soccer squad at the Olympics, objecting to the Bush campaign touting the team in political advertisements, Sports Illustrated, August 19th

Dog bites man

“This is perhaps why the president does not let him in the Oval Office.”

A journalist commenting on the president's dog, Barney, who, during a press conference in Crawford on August 23rd, defecated on the lawn about 15 feet behind his master. Washington Post, August 24th

Wounded knee

“He thinks probably that he never will really be able to run like he did again. Your legs are like tyres, and his are bald.”

Laura Bush on why her husband has given up running for mountain-biking. US News and World Report, August 30th

Now wash your hands

“You'd be amazed the number of people who want to introduce themselves to you in the men's room.”

John Kerry on the perils of being a presidential candidate. Daily Show, Comedy Central, August 24th

Breasts against Bush

“I truly feel in my heart that the president wanted to take the focus off of him at that time, and I was the perfect vehicle to do so at that moment.” *Janet Jackson, commenting on why her breast exposure at the Superbowl got so much coverage. Genre Magazine, October 2004*

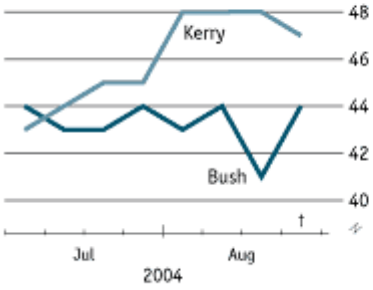
Smile, boys, smile

A new poll sponsored by BriteSmile, a manufacturer of tooth-whitening products, found that 58% of Americans think Mr Kerry's and John Edwards's teeth are most worthy of the Oval Office. Only 33% of participants voted for the Republican ticket's gnashers.

Washington Post, August 20th

The Economist/YouGov poll

*If the election were held today, who would you vote for...?, %**



Source: YouGov

Do you favour or oppose stem-cell research?†, %

	Favour	Oppose
Total	*68*	*15*
Men	*70*	*16*
Women	*67*	*14*
18-24	*62*	*18*
25-44	*68*	*14*
45-64	*65*	*18*
65+	*79*	*12*
Democrats	*79*	*6*
Republicans	*57*	*29*

*Registered voters †Conducted August 23rd-25th.

The full version of this split-sample question can be found at www.economist.com/yougov

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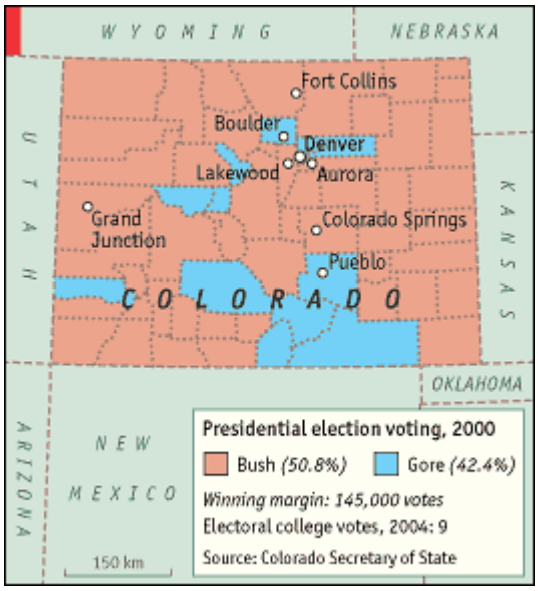
Swing states

Can Kerry carry cowboy country?

Aug 26th 2004 | DENVER
From The Economist print edition

The club of swing states has plenty of venerable members, such as Ohio and Pennsylvania. This year it may enrol an unexpected new one: Colorado



ON PAPER, the state that gave birth to the rodeo is solid Bush country. Colorado's Republicans have lost only one presidential election since 1964—in 1992, when Ross Perot split the Republican vote. George Bush won the state by eight percentage points in 2000. The Republicans control both houses of the state legislature as well as the governor's mansion (Bill Owens, one of the country's most conservative governors, won re-election in 2002 by 62% to 33%). Both of the state's senators in Washington are Republicans, as are five of its seven members of the House of Representatives. The Republicans have increased their edge over the Democrats among registered voters from 102,000 in 1996 to 181,000 today.

Yet the two most recent opinion polls in Colorado put Mr Bush and John Kerry in a dead heat, with 47% of the vote each. Republican jaws drop. How can that be?

Mr Kerry raised more money than Mr Bush in the months before the Democratic convention, and he has generally held on to leads in states such as Florida and New Hampshire. Now he wants to widen the presidential fight from the usual battleground states to include states that Mr Bush would like to take for granted.

There is a lot of talk in Kerry circles about “battleground clusters”. The argument is that Mr Bush is not as strong in the west as you might think—he narrowly lost New Mexico in 2000—and that the “western cluster” (Arizona, Nevada, New Mexico, Colorado) may provide easier pickings than some more familiar swing states.

The Democrats would love to make sure that Colorado is part of this western cluster. They have a fair chance of picking up both Ben Nighthorse Campbell's Senate seat and one or even two congressional districts. Sentiment plays a part. Mr Kerry was born in the state, in an army hospital near Denver; this helps him claim he's not just the Boston Brahmin his enemies call him. Anyway, the Democrats are not quite as feeble in Colorado as the list of the state's top office-holders might suggest. They held the governorship from 1974 to 1998. One reason why Mr Bush won Colorado so easily in 2000 is that Ralph Nader got more than 5% of the vote. The left-wingers of Boulder and Denver may not take that risk again.

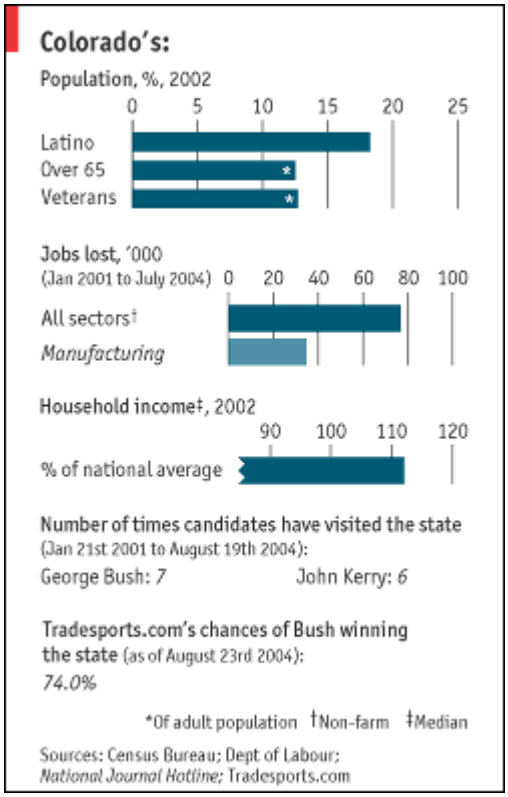
For their part, the Republicans go into the election with three potential problems. The most obvious is the economy. In the 1990s Colorado had proportionately more high-tech workers than any other state, and ranked third in venture-capital financing. All this changed with the bursting of the high-tech bubble. The “gazelle companies” that had once bred so merrily in Colorado's clear air have shed workers, or shut down. Wal-Mart, not Qwest, is now the state's biggest employer.

A combination of economic slowdown and tax cuts is playing havoc with the public finances: at one point, there was talk of selling some state buildings. The Republicans' image may be shifting from that of benevolent tax-cutters to mean-spirited wreckers of popular services.

The second problem is the fluidity of the state's population. In the 1990s the Republicans benefited from the large number of high-tech social conservatives who flocked to Colorado in search of a family-friendly environment. Enrolment in private schools rose much faster than in state schools, and the number of home-schooled children tripled. But lately the state has attracted a growing number of Latino immigrants. Latinos now make up 18% of its population.

Until now the Latinos have been punching below their weight. But this year the Democrats hope to take advantage of the fact that two popular Latino brothers are running for two of the state's most prominent jobs: Ken Salazar, the attorney-general, for Ben Nighthorse Campbell's Senate seat, and John Salazar for a House seat. New Mexico's governor, Bill Richardson, is helping to mobilise the local Latinos, and national Latino money pours in.

The third problem is the especially hard edge of Colorado's Republicans. This is a stronghold of both Christian conservatives and tax-cutters. James Dobson's mighty Focus on the Family has its headquarters in Colorado Springs. The state boasts two of the most conservative members of Congress—Marilyn Musgrave, a leading proponent of the constitutional amendment to ban homosexual marriage, and Tom Tancredo, a vociferous critic of lax immigration policy.



Splitting the vote

The Republicans' hard line has brought two difficulties. One is relentless faction-fighting. The religious right has been ruthless in using primaries to defeat moderate Republicans; it is now snapping at Mr Owens over the failure of his marriage. The second is the growing alienation of many moderate Republicans, particularly in the business wing of the party. Bill Clinton won the state in 1992 because 23% of Colorado voters preferred Ross Perot to George Bush senior. Votes could drift away again.

There is a further wrinkle. On the same day when they choose between Messrs Bush and Kerry, Colorado's voters will also have to decide on a ballot initiative that would shift the state's votes in the electoral college from a winner-takes-all system to a proportional one, based on the popular vote. The initiative explicitly says that it applies “retroactively” to the 2004 election. But the courts will have to decide whether it can do so. The Democrats have been all for the initiative. But what if Mr Kerry were to win the state and have to split those votes with Mr Bush? They could yet come to rue the measure if it passes.

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Debt in the Caribbean

A shadow on the beach

Aug 26th 2004 | PORT-OF-SPAIN
From The Economist print edition

The party's over for the Caribbean's spendthrift governments

THE people of Belize, a small former British colony in Central America, found out this month that their country's state pension fund had shelled out $3m to cover debt guarantees to a company owned by a former government minister. Seven ministers—more than half the cabinet—resigned, to demand the firing of the finance minister, Ralph Fonseca. But politics in Belize is a clannish affair. Said Musa, the prime minister, took over the finance portfolio himself, brought the rebels back into the cabinet and gave Mr Fonseca an odd mixture of new responsibilities: home affairs, investment and overseeing a proposed $225m bond issue.

Mr Musa knows that the voters will not have a chance to vent their fury at this cynicism until an election in 2008. Belize has rather less time to sort out its finances. Since Mr Musa took office in 1998, public debt has increased from 41% of GDP to 93%, much of it borrowed at commercial rates. The economy has grown, but much of the cash has been poorly spent. Critics point to half-empty state housing projects, and chaotic lending by the Development Finance Corporation, a government-owned body. Now the bills are falling due. An earlier attempt to issue bonds stalled in June. Mr Musa promises to come clean about any new borrowing and to publish full government accounts for last year. In a country not known for financial openness, that is progress of sorts.

Belize's politicians are not the only Caribbean spendthrifts. In proportion to the size of their economies, all 14 of the independent countries in the Caribbean Community (Caricom) are among the 30 most heavily indebted emerging-economy governments. Seven, including Belize, are in the top ten (see chart). The sums involved would be small change to, say, Argentina. The public debt of St Kitts & Nevis is less than $600m—but that is 160% of its GDP. Except in the case of the bluest-chip borrowers, economists worry when public debt goes much above 50% of GDP.

The borrowing binge is a recent affair. On average, the public debt of Caricom countries has risen by two-thirds since 1998. Unlike Latin American governments, some of whom are recidivist bad debtors, Caribbean countries, with stable currencies and democracies, until recently looked like good risks. So borrowing has been all too easy. Caribbean banks, not least in energy-rich Trinidad, are awash with cash and have been eager to lend—

provided there's a government guarantee.

Across Caricom, fiscal deficits have ballooned since the late 1990s. That was partly a result of more frequent hurricane damage, and other disasters (including the slowdown in tourism after September 11th 2001). More recently, high oil prices have forced some governments to cut fuel taxes. But policy has also been lax. Caribbeans expect governments to be big spenders. In Antigua, the Bird family held power for most of the past half century until an election in March; they abolished income tax but brought almost half the workforce on to the government payroll. Antigua's public debt soared to 114% of GDP.

For the debtor governments, the long beach party may finally be over. Rising interest rates will make new borrowing more expensive. In Jamaica, interest payments already eat up over half of government revenue. Even well-managed Barbados was downgraded this month by Standard & Poor's, a credit-rating agency, because of its rising debt.

Ratna Sahay, of the IMF's Western Hemisphere Department, concluded in a recent paper that a continuation of current policies would endanger the Caribbean's macroeconomic stability. Merely to stabilise public debt at its current levels will require aggressive fiscal tightening in several countries. Antigua has begun a painful clean-up: the new government is mulling new taxes.

To make matters worse, the Caribbean's record of economic growth has been mediocre. On average, its economies have expanded by 2.5% a year from 1980-2003—a little bit more than those of Latin America but less than the average for small island states, according to the IMF.

Two of the region's mainstays, tourism and offshore finance, face growing competition. The European Union is discussing changes to its protectionist sugar regime, which could mean it pays less for Caribbean cane. Raising growth rates will require policy reforms, including privatisation and more flexible labour markets, reckons Ms Sahay. Much could also be gained from better management of the public finances—something which the Caribbean Technical Assistance Centre, an internationally funded body set up in 2001, is trying to help with.

But in the Caribbean, there is a Micawberish assumption that when things get really tough, someone will step in to provide. Taiwan's president, Chen Shui-bian, is due to visit Belize next month. Mr Musa will be presented with the Order of Propitious Clouds with Special Grand Cordon. He may be expecting something more.

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Farming in Argentina

The green desert

Aug 26th 2004 | PINTO, ARGENTINA
From The Economist print edition

Pros and cons of the soya boom

PINTO, a small village in northern Argentina, has the air of a place under siege. As he watches bulldozers in a neighbouring property ripping up trees and scrub to make way for soya plants, Adolfo Farias, a local peasant farmer, draws parallels with the Spanish conquest. He says the loss of the forest is changing the local climate, causing both droughts and flooding, while cropdusters spraying pesticides have wiped out the village's cotton crops and poisoned its water. “They are destroying the land,” he claims.

Mr Farias's complaints form the dark side of a farming miracle. Since 1997, Argentina's already efficient farmers have more than doubled crop yields. Soya production has tripled: the crop now covers around half of the country's arable land. Soya accounted for a quarter of total exports last year, and brought the government $1.5 billion in export taxes. Farm exports have been the mainstay of the swift recovery from Argentina's economic collapse of 2001-02.

This boom rests on innovations such as direct sowing. This method eliminates ploughing, limiting erosion and maintaining humidity. But it requires more use of fertiliser. Genetically modified seeds, especially of soya, are in widespread use.

Welcome though it has been, the soya boom arouses some worries. One is of a glut: the world price of soya has fallen by 40% from its March peak, mainly because of lower demand in China. The other is that monoculture and less crop rotation risks exhausting the soil.

To some, these concerns look overblown. Argentine farmers are swift to switch crops according to market conditions. Ernesto Ambrosetti, an economist at the Rural Society, the main farmers' lobby, points out that they turned to soya partly as the safest bet during Argentina's recent political and economic turmoil. As bank lending returns, and if soya prices fall, farmers will switch to crops such as maize, which offer lower returns but return nutrients to the soil. “They know you can't keep planting soya year after year,” he says.

Others are less sanguine. Miguel Teubal, an economist at the University of Buenos Aires, reckons that two dairy farms a day are disappearing to make way for soya. Since milk production involves big investments in equipment, they have probably gone for good. The same applies to fruit orchards or cattle fences uprooted to make way for soya. Jobs have gone as modern, mechanised farms replace traditional ones. By one estimate, over 100,000 smallholders have given up in the last decade. Mr Teubal also blames soya for the fact that food prices are rising faster than overall inflation—though food is still relatively cheap in Argentina.

Environmentalists abhor what they call the “green desert” of soya. Argentina has lost three-quarters of its native forest to farming over the past century. But in places like Pinto, the problems of peasant farmers owe much to politics. In April, the federal government stepped in to run Santiago del Estero, because of abuses by the local governor. Pablo Lanusse, the province's new administrator, denounced many of the land clearances as illegal.

Defenders of high-tech farming insist that existing laws, if enforced, are sufficient to preserve the environment. They point out that glyphosate, the herbicide used with GM crops, is safer than the alternatives and degrades on contact with the soil. The government apparently shares that view: it recently approved GM maize. The modernisation of Argentine farming looks unstoppable. On balance, it has been positive for the country. But for many of the families who have lived on the land for centuries, change is painful.

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Housing in Mexico

An overlooked revolution

Aug 26th 2004 | TECÁMAC, MEXICO
From The Economist print edition

Laying the foundations of a property-owning democracy

UNDER President Vicente Fox, Mexico has acquired a reputation for economic stagnation and political inertia. That is not the view from a bridge over the main highway heading north-east from the capital, Mexico City, near the town of Tecámac. Here, amid noise and dust, for just about as far as the eye can see the landscape is covered with giant housing estates at various stages of construction. They are part of a building boom that is quietly transforming Mexico under the noses of the quarrelling politicians.

The size and suddenness of the developments at Tecámac is startling. Three private firms are involved: Geo has built 7,500 houses in three years, Urbi 14,000 in five while Grupo Sadasi hopes to finish a development of 33,000 houses by December. Sadasi has bought a site on the other side of the highway on which it aims to build a further 40,000 homes by 2007. In less than a decade, a satellite city of 500,000 people will have emerged.

It is easy to see why Mexicans flock to Tecámac. The houses are small and in monotonous, regimented rows. But one Mexican in two lives in a self-built home, often a shack on a sliding hillside on the crowded fringes of cities. At Tecámac, the houses have solid roofs, plumbing, electricity and car-parking. The roads don't turn into rivers at the first drop of rain. The brand new schools, which the developers are obliged to build by the local municipality, are five minutes' walk away rather than an hour or more on the bus. And the homes are affordable for ordinary Mexican workers: about nine out of ten of them cost between $23,000 and $25,000.

The Tecámac effect is being repeated across the country. While the economy was sluggish between 2000 and 2003, construction expanded at over 5% a year. Not coincidentally, the only new listings on the Mexico City stock exchange in the past two years have been by three building firms. The builders reckon there is room for much more: although 450,000 new homes were built by the industry in 2003, Geo says that demand is almost twice that.

The housing boom owes much to measures taken by Mr Fox's government after it came to office in 2000. New mortgages by commercial banks, numbering 100,000 a year a decade ago, dried up after Mexico's devaluation and banking collapse of 1994-95; last year there were just 12,000. Mr Fox's government took two steps to revive and expand the mortgage market.

First and most important was to reform the Institute of the National Fund for Workers' Housing. Created in 1972, this body receives a levy paid by private-sector employers and equal to 5% of their wage bills. Under the rule of the Institutional Revolutionary Party (PRI) until 2000, the institute was a pork barrel for politicians and trade-union leaders. It tendered directly for houses (a process riddled with corruption and kickbacks), assigning them by fiat to beneficiaries.

Mr Fox turned the institute from being an ineffective housebuilder into a mortgage lender for its members, who now have individual accounts with it. Between 1972 and 2000, the old institute extended just 2m mortgages. From 2000 to 2003 alone, it granted 1m; that figure is expected to grow to over 1.8m by the end of Mr Fox's term in 2006. The institute claims that it will have housed 8.1m Mexicans (out of a total of 100m) in six years.

The second step was to give a new role to the Federal Mortgage Society, a previously obscure quasi-governmental body. It has been given a federal guarantee, and is providing finance for Mexico's building societies—themselves set up only a decade ago. To speed housebuilding, the societies have been allowed to lend some $1.5 billion to small and medium-sized building firms. Already, increased competition among mortgage providers has seen a fall in the average deposit demanded by lenders from 35% of the

sale price to 10-13%.

The head of the mortgage society, Guillermo Babatz, insists that these measures are not intended to supplant private mortgage-lenders, but rather to help nurse them into health. The aim is for the society to lose its federal guarantee by 2009 and return to a “much diminished role”, he says. Just as well, perhaps: some analysts are worried that the supply of houses is starting to outstrip effective demand.

The housing boom is beginning to change Mexico in several ways. Nearly all of the new homebuyers are singles or young families who before would have lived in the parental home for much of their lives. The traditional extended family may fragment—or younger Mexicans may be emancipated from it. Nearly all of them are buying property for the first time. Rather than the fog of uncertainty of traditional land law, they are getting proper title deeds.

Mr Babatz calls this a “silent revolution”. Mexico is laying the foundations of a property-owning democracy. As this spreads, it will reduce the scope for the patronage politics of the past, even if the PRI or its offspring, the leftish Party of the Democratic Revolution, should win the election in 2006. Mr Fox pledged to build 750,000 houses a year by the end of his term. It is perhaps the only one of his numerous campaign promises that he may end up fulfilling—and it looks certain to be one of his most lasting legacies.

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Peru

Difficult truths

Aug 26th 2004 | LIMA
From The Economist print edition

An indifference to past crimes

THE past year has been a frustrating one for relatives of those killed in political violence in Peru in the 1980s and 1990s. On August 28th last year, a Truth and Reconciliation Commission published an exhaustive report into the violence unleashed by the Shining Path guerrillas. It found that 69,280 people had died between 1980 and 2000—three times as many as previous estimates. The commission identified 150 people it said should be prosecuted. It urged reparations for the victims, and suggested ways to prevent a repetition of violence.

A year on, not much has happened. In February, President Alejandro Toledo's government set up a group to study the commission's proposals. Congress held hearings. The judiciary has set up special human-rights courts. But nobody has been prosecuted or compensated. “There was indifference when the violence was occurring and we are once again witnessing indifference,” said Rolando Ames, a commission member, at a sparsely-attended event held to mark the report's anniversary.

Unlike similar exercises elsewhere in Latin America, in Peru the commission scrutinised the conduct of elected governments. Alan Garcia, president from 1985-90, is now the leader of the opposition. Alberto Fujimori, who ruled Peru for a decade from 1990, is a fugitive in Japan. But polls show he is still supported by some 20% of Peruvians.

The commission blamed the Shining Path for 54% of the killings, and the army and police for 37%. But many of the guerrilla leaders are already jailed or dead. Many of those identified as unpunished perpetrators of crimes are army officers. Mr Toledo's weak government purged the army of many corrupt generals. It is wary of alienating it further.

Most Peruvians are more preoccupied with how to make ends meet than with the past. Mr Toledo says the state should pay reparations. But his government lacks the cash for this. Instead, it may try to steer spending to areas worst-affected by the violence. Whoever wins the next election, supporters of Mr Garcia and of Mr Fujimori will have many seats in Congress. It may be too much to imagine that the commission's proposals will be implemented in full. But as long as some of the worst crimes of the past remain unpunished, the risk is that they could be repeated.

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Pakistan

The banker, the mullahs and the inscrutable general at the top

Aug 26th 2004 | ISLAMABAD
From The Economist print edition

Reuters

With a technocrat as prime minister, Pakistan is still far from democracy

Get article background

LIKE many a military ruler before him, Pakistan's president, Pervez Musharraf, is all for democracy. It's just the practitioners of it that he can't abide. Even the most affably docile, such as Zafarullah Khan Jamali, prime minister until June, are prone to buckle under pressure from their parties and voters. How much better a prime minister shackled by no such chains! One, moreover, so rich as to be above venality (or even drawing a salary). One, in short, like Shaukat Aziz (above), who is about to be sworn in to office.

In 1999, after General Musharraf seized power in a bloodless coup, Mr Aziz gave up a successful 30-year career as an international banker to become Pakistan's finance minister. He has done a good job. His latest promotion will be welcomed by many of Pakistan's businessmen and international creditors, as well as by foreign diplomats, hopeful that a prime minister whose main interest is economic growth will be a good partner in peace talks with India. But Mr Aziz's appointment does not answer the big question in Pakistani politics: whether the general will, as promised, doff his uniform at the end of the year and serve out the rest of his presidential term, until 2007, as a mere civilian. That was the deal the general cut last year with the Muttahida Majlis-i-Amal (MMA), an alliance of six Islamist parties, which leads the parliamentary opposition.

In some ways, indeed, Mr Aziz's appointment represents a failure for the general's experiment with limited democracy. Mr Jamali, although a presidential loyalist, was a politician. Besides his assigned chore, running the government, he started meddling in policy and in managing the awkward coalition (and thin majority) that backs it. Mr Aziz, who was a senator, had no political constituency at all until August 18th, when he acquired a couple. To make double sure, and to give the impression of broad support, two safe government seats had been vacated to allow him to win by-elections to the lower house of parliament—a constitutional requirement for the prime minister. No wonder he is nicknamed “short-cut”.

Unlike Mr Jamali, Mr Aziz is a technocrat. The politics can be left to Chaudhry Shujaat Hussain, leader of the pro-Musharraf Muslim League, backbone of the ruling coalition. On August 25th, when he resigned, Mr Hussain became the only civilian prime minister in Pakistan's history to have served a full term in office, albeit just the two-month interregnum while Mr Aziz passed his irksome electoral test. This is a

record that does not augur well for Mr Aziz. With no independent power-base, he will find himself squeezed between the president's orders, the party's demands and coalition partners' threats. The result is that Pakistan will find itself looking even less like a functioning democracy than it does now.

That matters for America. Pakistan is a vital ally in the war against al-Qaeda. Its importance has been highlighted in recent weeks with the arrest of more than 30 terrorist suspects in Pakistan. On August 21st, for example, the government announced that a number (between five and ten—it seemed to be unable to produce a consistent count) had been caught before they could carry out a series of planned attacks against Pakistani leaders on independence day, August 14th.

Two days later, it reported that the army had killed four terrorists, including three foreigners, in the wilds of South Waziristan, where Pakistan blurs into Afghanistan. Despite this, and protestations of friendship to Hamid Karzai, Afghanistan's president, who was visiting Islamabad this week, there are still suspicions that Pakistan is less than zealous in pursuing remnants of the Taliban on its Afghan borders. Curbing al-Qaeda-linked terror at home, however, is a matter, quite literally, of life and death for Pakistan's leaders. General Musharraf has narrowly escaped two assassination attempts. And nine people died in an attack last month on Mr Aziz.

One reason for suspicion about General Musharraf's sincerity in purging Pakistan of extremism has been his reliance on an accommodation with the Islamist parties in the MMA. General Musharraf may be gearing up to confront them. The government has been raiding *madrassas*, the private Muslim schools, as part of its terrorist hunt. The interior minister has accused a leading MMA member, Jamaat-e-Islami, of harbouring fugitives.

But a real showdown with the MMA is unlikely. As so often, the mullahs are easier to deal with than is the main secular opposition—the parties of exiled former prime ministers Benazir Bhutto and Nawaz Sharif. This is partly because there are two swords hanging over the MMA. One is the threat of dismissal of governments in the two provinces—North-West Frontier and Baluchistan—where it is enjoying its first taste of power. The other is a case before the Supreme Court that questions whether the *madrassa* degrees held by many MMA MPs meet parliamentary educational criteria.

These convenient weapons may prove useful if General Musharraf decides not to leave the army after all. A decision will follow a round of top-brass retirements due in October. Thereafter, the president may feel secure enough in the men he has promoted to stand down. Or he may judge from his own experience (and that of a predecessor, General Zia ul-Haq) that anyone running the army will one day want to run the country, too. But if he keeps his uniform, he will have created a dangerously frustrating promotion bottleneck in the senior ranks. As Mr Aziz may find, in Pakistan's politics it is easier to take a shortcut to the prime minister's office than away from military rule.

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Nepal

Bombs on the tennis courts; no petrol in the pumps

Aug 26th 2004
From The Economist print edition

Maoist rebels show their power

Reuters

Better stay at home

Get article background

Potatoes usually cost 25 rupees (35 cents) a sack on the streets of Katmandu. But during a week-long blockade by Maoist rebels, prices doubled, and even tripled. Most other foodstuffs followed suit, fuel was rationed at petrol stations and buses in and out of the Nepalese capital were suspended. The blockade was eventually lifted on August 24th after calls from businesses, human-rights groups and, above all, ordinary citizens.

The blockade was the latest twist in a three-way conflict that has raged since 1996 between the government, the monarchy and the Maoists. After a seven-month ceasefire last year failed to give birth to a peace agreement, the violence has slowly resumed. The rebels are now flexing their muscles: this is the first time that they have directly targeted the capital. Their affiliate, the All Nepal Trade Union Federation, has called for the closure of the main businesses in the country. The blacklist includes several multinationals, such as Bottlers Nepal (Coca-Cola), Surya Nepal Ltd (the largest cigarette producer), and luxury tourist venues. The aim appears clear: to destabilise the government by putting pressure on the economy.

On the whole, the Nepalese economy has shown amazing resilience in the face of the many disturbances it has endured. But growth has undoubtedly been slowed by the conflict. Nepal's finance minister admitted as much in his 2003-04 economic survey, released last month, though he was still able to record an impressive (in the circumstances) growth figure of 3.6% for the previous fiscal year.

Tourism, on which some 1.25m people depend, is also suffering. Although there are no reports of direct attacks on tourists, incidents such as the four bombs dropped on the tennis courts of the Soaltee Crowne Plaza hotel on August 16th hardly make good publicity. Since a record high of 500,000 visitors in 1999, tourism has steadily declined as the conflict has escalated: by 2002, the number had fallen to 215,000. Since then, the situation had begun to look more promising, with arrivals up by a quarter last year and by a further third this year. But recent events hardly bode well for the post-monsoon season.

The conflict-ridden areas, notably most of the western half of the country, are bone poor. A recent survey found that less than 37% of children were vaccinated in two districts affected by the rebellion, compared with a national average of 75%. Education is also affected. Attacks on teachers have forced many to leave, and charities have reported security difficulties in remote areas.

Nepalis are not the only ones worried about the long-term effects of the conflict. Foreign investors and neighbours are also anxious. India provides 40% of Nepal's foreign investment and has stakes in most of the companies affected by the recent strikes. The Indians have also put up with an increasing flow of migrants from Nepal. In January 2003 alone, Indian officials say, 120,000 Nepalis crossed the border. These are mostly young men in their 20s, desperate to escape the daily extortion of money by the rebels or information by the army. Many rural areas are consequently devoid of young workers.

Instead, the economic mainstay of the kingdom has become the money sent home by young Nepalis abroad. Hard statistics are scarce, but remittances are thought to comprise 12% of GDP, and the figure is growing.

The Maoists' politics are a far cry from anything the Chairman would recognise. They want to overthrow the monarchy and replace it with a genuine democratic system—not one, as at present, in which the king can dismiss the government at his royal whim. But if their ostensible aim is noble enough, their tactics are often brutal. And as this month's blockade shows, their stunts can easily backfire, worsening the lives of the very people they seek to rally to their cause.

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Bangladesh

A bomb too far

Aug 26th 2004 | DHAKA
From The Economist print edition

Politics nears meltdown

Get article background

IS BANGLADESH slithering into anarchy? This week, the country was paralysed by strikes, and tens of thousands of people took to the streets after an assassination attempt against the opposition leader and former prime minister, Sheikh Hasina, on August 21st. Witnesses said eight grenades were hurled from the roofs of neighbouring buildings towards the lorry from which she was addressing a crowd 20,000 strong in the capital, Dhaka. At least 18 people were killed and hundreds more injured. Sheikh Hasina's sari was splattered with their blood.

The explosions sparked an immediate response. Supporters of the opposition Awami League rioted in the centre of the city and fought with the police. A train and dozens of cars were set on fire, as were local offices of the largest party in the ruling coalition, the Bangladesh Nationalist Party. Sheikh Hasina blamed the government for the attack. The Awami League called two days of strikes, which brought the country to a halt. More protests, and violence, are expected.

Ironically, the rally in Dhaka was being held to protest against another bomb attack earlier in August. An explosion in the car park of a hotel in Sylhet, where the city's Awami League mayor, Badruddin Kamran, was meeting supporters, killed one man and left 30 injured.

Bombs are far from unusual in Bangladesh. Over the last five years around 140 people have been killed and more than 800 wounded in 16 major blasts and more smaller incidents. Cinemas, journalists and the British High Commissioner have been targeted.

The Awami League has called for opposition parties to unite against what it says is the rising threat from Islamic fundamentalism—though no-one knows for sure who is behind the bombs. Police have made no progress, except in one case. The opposition claims the extremists are being protected by sympathisers in the two Islamist parties in the ruling coalition.

The government is quick to deny the allegations. “This country has been identified as a moderate Islamic country and there is no scope for fundamentalism here,” said Harris Chowdhury, the prime minister's political secretary. But there seems to be plenty of scope for chaos.

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Japan

Finding a second wind

Aug 26th 2004 | TOKYO
From The Economist print edition

Can Japan's economy regroup after a soft second quarter?

Get article background

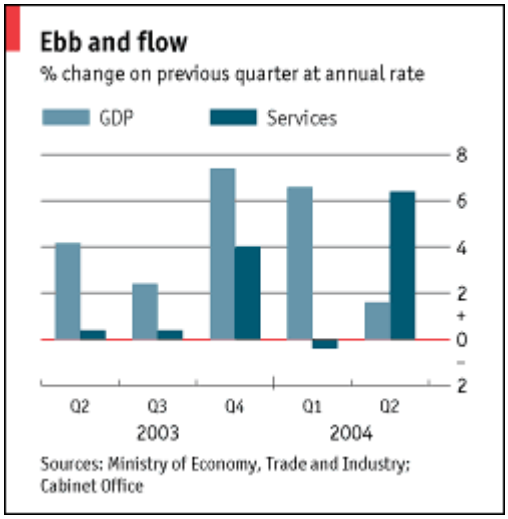
IF JAPAN'S impressive rebound really is winding down, Junichiro Koizumi could be in trouble. Not long ago, the economy seemed such a strong point—real GDP grew at a 6.6% annual rate in the first quarter of this year, following 7.4% growth in the previous quarter—that the prime minister asked his politically untested economy minister, Heizo Takenaka, to run in July's upper-house election. Mr Takenaka's victory was practically the only bright spot for Mr Koizumi, whose Liberal Democratic Party did badly at the polls. This week, however, Mr Takenaka was struggling to bolster confidence in an economy that turns out to have slowed sharply in the second quarter: real GDP grew at a mere 1.7% annual rate, the worst showing in five quarters.

One cause for worry is that investment in capital equipment, which has helped to drive Japan's brisk recovery, went flat in the second quarter. On August 24th, however, Mr Takenaka pointed out that machinery orders, which tend to be a leading indicator of fresh capital spending, “weren't that bad”, rising 10.3% in the second quarter. He conceded that high oil prices bear watching, but Japan so far seems to be taking them in its stride. Of course, rising energy costs could slow the global economy, and hence exports. Japan's manufacturers have low stockpiles of products to sell, however, and should not have to slow production much in response to mildly weaker demand.

A few quirks in the data also offer grounds for hope. The weak second-quarter figures partly reflect a poor adjustment for the leap-year effect, which made the first quarter look artificially strong relative to the second. “If you just average the two, you probably get close to something that is useful,” says Richard Jerram, a Tokyo-based economist at Macquarie Securities, an Australian outfit. First-half growth of 5.5%, at an annual rate, looks pretty good. And since the economy has been slowing less abruptly than the quarterly GDP figures suggest, there is still a chance that the recovery can continue at a decent clip.

Much depends on household consumption, which over the past couple of years has rebounded less convincingly than exports, profits or business investment. Here, signals have been mixed lately. Retail sales slid in May and June. But Japan's broadly defined services index, which is a good gauge of non-manufacturing strength, rose sharply (see chart). Mr Jerram uses the index to estimate consumer spending on services, which he reckons grew 3.0% in the second quarter, year-on-year.

An improving jobs outlook seems to be helping. Most economists expected the latest measure of job offers, due out on August 27th, to stay near its recent high level of more than eight job offers for every ten applicants. And the Olympics, in which Japanese athletes are already only one gold medal short of their record at the 1960 Tokyo games, have given a boost to sales of sportswear and home electronics. If Mr Koizumi is lucky, the recovery will show as much stamina as Mizuki Noguchi, who found a late burst this week to win the women's marathon.



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Thailand

Proxy war

Aug 26th 2004 | BANGKOK
From The Economist print edition

Why the ruling party is sitting out Bangkok's big battle

Get article background

VOTERS in this weekend's mayoral election in Bangkok can be forgiven for feeling perplexed. No fewer than 21 candidates are vying for the job, ranging from former diplomats and police officers to a massage-parlour boss who admitted to bribing police with trays of (genuine) Rolex watches. A businesswoman who posed in lingerie in her fliers was disqualified for an overly boisterous campaign. Other hopefuls have donned hard hats and posed in front of air-brushed building sites to show they mean business.

Amidst the hoopla, there is one strange omission. None of the candidates is from the ruling Thai Rak Thai (TRT) party, which is gearing up for a general election within six months. But the TRT's ebullient leader, the prime minister, Thaksin Shinawatra, has clearly signalled whom he favours to win: social activist Pavena Hongsakul. A member of parliament for the defunct Chart Pattana party, which recently merged with the ruling party, Ms Hongsakul is nonetheless running as an independent. She denies any deal with TRT, even though its councillors have been seen out canvassing for her.

Why should Mr Thaksin shy away from fielding his own candidate? The answer depends on whether you consider Sunday's ballot as a proxy vote on national politics or a colourful sideshow. Bangkok's mayor may be the country's only elected provincial boss (the prime minister appoints the others), but the post is far from mighty. Collecting rubbish and running primary schools are the main areas of responsibility. The outgoing mayor found time to host a television cookery show.

Still, the opposition Democrat Party is taking the race seriously. It wants Bangkok's middle classes to register a protest vote against Mr Thaksin's populist bluster, which critics decry as Asian authoritarianism, and elect Apirak Kosayodhin, the former boss of a mobile-phone company. Some Democrats see Mr Kosayodhin, at 43, as future leadership material, and hope a victory on Sunday can revive its fortunes in time for the national elections.

Unsure of Bangkok's fickle views and split over its choice of candidate, the TRT opted in May to stay out of the race, at least on paper. In practice, its deep pockets have benefited Ms Hongsakul and reportedly at least two other nominally independent candidates as well. Call it soap-powder marketing tactics: more of your own brands mean that there is less shelf space for a rival brand. The outcome could be a nail-biting count.

The TRT will try to have it both ways. Should Mr Kosayodhin win, it can be written off as a local quirk, not a government loss of face. But if he falters, Mr Thaksin will be quick to crow at the hapless opposition, or what remains of it after a string of recent defections to the ruling party.

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China

The Great Leap west

Aug 26th 2004 | KASHGAR
From The Economist print edition

The "Hanification" of Xinjiang province

IDH KAH Mosque, a towering structure in central Kashgar, the westernmost city in China's vast province of Xinjiang, has always been a prime meeting place for Uighurs, the Muslim Turkic people who historically dominated Xinjiang. The square outside the mosque, venerated in Uighur writing and song, used to look like Amman or Tashkent, full of skullcap-wearing Muslim men, vendors selling Arabic CDs, and kebab sellers carving hunks of fatty lamb from steaming carcasses.

These days, though, the area increasingly resembles Shanghai or Shenzhen. In the old city of Kashgar, Uighurs sit out in front of their ancient mud-brick homes and watch Chinese building workers dig huge ditches in front of their doors in preparation for their destruction. Chinese firms are razing traditional homes near the mosque—without, the Uighurs complain, paying anything close to decent compensation—in order to build flashy new shopping centres and apartments catering to the ethnic Chinese who are flooding in to Kashgar. For decades the government in Beijing has relocated Han Chinese to Xinjiang to dilute Uighur influence over the restive province, which before 1949 was briefly an independent state. But until recently most Chinese migrants went to Xinjiang's east, which had fewer Uighur people. Now, with the construction of a new railway and an oil pipeline to western Xinjiang, and large state subsidies there for Chinese contractors, the Chinese are encroaching on areas, such as Kashgar, that the Uighurs consider their cultural heartland. Combined with a crackdown on Uighur political and religious activity, this has made Xinjiang an edgy place.

The shift in Xinjiang's population is striking. China's most recent census showed the Han Chinese population rising twice as quickly in Xinjiang as the Uighur population. And these figures do not take into count the tens of thousands of Chinese "migrant workers" who come to Xinjiang for building jobs and never leave. This shift is obvious on the ground. Large sections of southern Kashgar, situated around the Wenzhou Hotel (Wenzhou is a city in eastern China), are filled with Chinese-owned businesses, many of which reportedly get help from local officials when competing with Uighur firms. Homes and offices for Chinese are springing up throughout Kashgar over the rubble of Uighur buildings.

Meanwhile, since September 11th 2001, Beijing has tried to link Uighur nationalist groups to al-Qaeda, even announcing that around 1,000 Uighurs trained with Osama bin Laden's organisation. A few Uighurs did indeed fight for the Taliban regime in Afghanistan, but most support non-violence, and there is little evidence of significant al-Qaeda links. Yet America at first played along with Beijing's fiction, placing an obscure Uighur group on its list of international terror groups, a designation China used to tar all Uighurs as terrorists. (China now defines a terrorist in Xinjiang as anyone who thinks "separatist thoughts".) Under this pretext, China has over the past two years detained tens of thousands of people in Xinjiang—and executed many of them, according to Amnesty International. The authorities in Beijing recently said that this crackdown would continue indefinitely.

All this does not bode well for Xinjiang's future. Uighurs report that small-scale clashes break out nearly every day between Chinese and Uighurs in Xinjiang's western cities. The instability scares off foreign investors—foreign oil firms have pulled out of the pipeline project—which might be more willing to employ Uighurs than Chinese state companies are. And moderate Uighurs, who want autonomy but not necessarily independence, worry that repression and Chinese immigration are playing into the hands of the most hardline, conservative elements in Uighur society. Though the Uighurs historically were among the world's most liberal and pro-western Muslims, fundamentalist Islam is gaining sway among young Uighur men.

Still, there is hope. Recognising the threat posed by hardliners, the leading moderate Uighur diaspora organisations, which used to spend most of their time squabbling, came together at a conference in Germany in April to unite behind one leader, Erkin Alptekin. The Uighurs hope that Mr Alptekin, the son of a pre-1949 president of independent Xinjiang, can become their Dalai Lama, promoting the Uighur cause in the West and serving as a moderate, unifying force for their nation. Even some American officials are beginning to realise that China's definition of “terrorism” simply means anyone who opposes Beijing. When Mr Alptekin visited Washington earlier this summer, he was feted by congressional staffers, while the National Endowment for Democracy, which gets funding from Congress, has recently given a grant to a moderate Uighur exile group in America.

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Sudan

Decision time in Sudan

Aug 26th 2004 | KHARTOUM
From The Economist print edition

EPA

As Darfur burns and a UN deadline looms, the mood in Khartoum is confused

Get article background

AT A sweaty open-air meeting in the Sudanese capital, Khartoum, a youth shouts into a microphone. He tells his audience, who are mostly students from the stricken region of Darfur, of how a suspected member of the dreaded *janjaweed* militia was spotted straying into a refugee camp there. As he describes how the refugees hacked the man to death, the crowd erupts with fist-waving cheers. Considering that there are thousands of Darfuri students in Khartoum, some of them armed, it would seem that Sudan's government faces threats not only in the remote west of the country, but also on its doorstep.

The Arabic word for “problem” is *mushkilla*. In Sudan, the problems are as vast as they are numerous. The tragedy in Darfur started when the government was challenged by two small rebel movements there. To fight them, Sudan's rulers chose the cheap option of arming and lending air support to a militia composed of the rebels' traditional tribal enemies, and encouraging them to murder, rape and rob the rebels' ethnic kin. The result has been some 50,000 people killed, 1.2m forced to flee their huts, international outrage and a mammoth relief effort.

But that is only one Sudanese *mushkilla*. Far to the east, the restive Beja and Rashaida tribes are threatening to cut the single paved road that links Sudan's vast interior to the sea. Big *mushkilla*s plague the south, too. Following half a century of intermittent but savage warfare and perhaps 2m deaths, the government and the main southern rebel group have all but clinched a complex deal to share power and resources. Now, the impending return of some 3.5m displaced southerners to their ravaged homelands threatens a new type of trouble. Other chronic *mushkilla*s include drought, locusts, disease, poverty, resentment at the monopolisation of power by a few clans from the northern Nile Valley, and the vexed question of Islam's role in the state.

Sudan's woes are due in part to history, nature, and the doubling of the population since 1970 to 34m. They also owe much to the constant, mostly inept, frequently brutal and always thwarted efforts by governments in Khartoum to mould in their own image a nation that varies hugely in ethnicity, religion, language and tradition. The Islamist-leaning, army-backed regime of President Omar Bashir has proved no exception since it took power in a 1989 coup. But maintaining the pretence that Sudan is a cohesive, centralised, conservative Muslim and Arab state has never been costlier than now. As a top Sudanese

official admits, the few months of crisis in Darfur have tarnished the country's image more than all the years of war in the south.

The government feels beleaguered. The UN Security Council has given it until August 29th to stop the killing in Darfur, allow help to reach the region's people, and disarm the militias that have been terrorising them. Should it fail to comply, the regime may be punished, though exactly how is not clear. Hoping to appease its critics, the regime is negotiating this week with the Darfur rebels. At the same time, it is under pressure to put the final seal on peace with rebels from the south, as well as to accommodate the grievances of various secular northern opposition parties.

Some relief, but not enough

None of this diplomacy would be easy, even without the mix of bluster and foot-dragging with which Mr Bashir has often addressed it. It does not help, for example, to insinuate that the 150 Rwandan troops sent by the African Union to help monitor a frail ceasefire in Darfur could be carrying AIDS, or to dismiss the satellite photos of burned Darfuri villages released by America's State Department as “espionage”. Yet it would be unfair to say that Khartoum has failed utterly to respond to international pressure.

Sudanese officials point out that the regime has deployed several thousand extra police to Darfur, granted “fast-track” access to the region for aid agencies, approved a plan to establish safe areas for refugees and belatedly admitted that its tribal allies have committed serious crimes. The number of aid agencies working in the 137 refugee camps spread across Darfur has more than doubled in the past two months, to 47. Aid workers agree that the violence has diminished, and that help is reaching most refugees. They also agree that it may not be easy to disarm marauding bands across an area the size of France, and that Khartoum has reason to accuse Darfur's two rebel factions of carrying out their own atrocities (see article).

But the terrorisation of civilians by the government and its allies continues. As recently as August 10th, the Sudanese air force was still bombing villages. Refugees still straggle across the border into neighbouring Chad. Even at camps close to Darfur's main cities, residents still fear death if they venture out. Poor roads, rough ground and seasonal rains have cut off large areas, including the fertile, rebel-controlled highlands of Jebel Marra. No one knows what horrors lie there.

Given Sudan's troubles, one would expect Khartoum, a shambolic sprawl that barely shelters its 6m polyglot people (a third of them refugees), to feel like a city under siege. There is certainly much weariness, some fresh anxiety, and a great deal of anger against the government. But the sheer size of Sudan means that to many people in the centre, rural carnage is too distant to be of much concern. Few people can afford to travel within the country, even if they can get permission to do so.

Besides, though Darfur is in agony, the rest of the country is doing less wretchedly than before. GDP growth may reach 6.3% this year. Inflation has fallen from triple to single digits since the mid-1990s. The price of land in Khartoum has risen tenfold in as many years. Wealthy Sudanese are investing in their own country for the first time in a generation. The main reason is oil, which was discovered in 1979 on the border between north and south Sudan, but only began to flow as the north-south war abated. The country now exports 250,000 barrels a day, a figure that could quintuple within a decade.

Some Sudanese officials seem to think that oil money, plus backing from fellow Arabs as well as China, India and Malaysia (whose firms have invested billions in Sudan's oilfields), will enable them to resist the pressure to cede power to those, such as the Darfur rebels, who clamour for a fairer share.

Others say that America's difficulties in Iraq have sapped its will to play hardball with rogue regimes. All agree that the West sheds crocodile tears for Darfur to disguise its true interest in Sudan's untapped riches. Conspiracy theories are popular even among the most powerful and best-educated Sudanese.

It may be, however, that Mr Bashir will soon face pressure to moderate his behaviour from his own constituency: the northern, Arabised and Muslim middle class. As the economy revives, this group has more to lose than ever before. And they are awfully tired of war.

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Darfur's rebels

No angels

Aug 26th 2004 | WADI BARDI REFUGEE CAMP, WEST DARFUR
From The Economist print edition

The Sudanese government is not the only villain

Get article background

THE gunmen attacked on horseback, burning huts and killing anyone who crossed their path. Distraught survivors fled the blackened wreckage of their village for a refugee camp, where they now huddle in grass shacks. The story is wearily familiar, but with one surprise. The men who torched the village of Ishbara were not from Sudan's notorious government-backed *janjaweed* militia. They were from the Sudan Liberation Army (SLA)—the rebel force the *janjaweed* was recruited to crush.

Neither side is innocent in Darfur, though their victims usually are. Granted, the two rebel groups there—the SLA and the Justice and Equality Movement—have not committed atrocities on anything like the scale of those perpetrated by the Sudanese government and its *janjaweed* allies. But their methods can be equally ugly.

Refugees from the Ishbara raid now live with nearly 10,000 others in a camp called Wadi Bardi. They recite the names of 12 villages that the rebels burned to cinders, and another five whose people were so petrified that they fled without waiting for the gunmen to arrive.

The SLA consists largely of members of the Zaghawa, a tribe long hostile to the regime in Khartoum. Wadi Bardi's people are from the Gimr tribe, traditional rivals of the Zaghawa. Some SLA leaders reason, implausibly, that anyone who hates the Zaghawa must love the government, so they paint all Gimr as lackeys of Khartoum, and their mounted warriors ravage Gimr villages.

It is the same harsh logic that the government uses to justify its ethnic cleansing. In January, the army razed the Zaghawa village of Gilgira, forcing its 3,000 inhabitants to flee into Chad. Local officials claim that Gilgira was a rebel hotbed. One likens its destruction to the way America treats countries that shelter Osama bin Laden.

The rebels claim to be fighting to emancipate Darfur's black Africans, but they are vague as to whether their aim is independence, autonomy or a fairer share of the national cake. The closest they have to a manifesto is the “Black Book”, a document that began circulating in 2000, which catalogues how a handful of people from three Arab tribes have grabbed most of the power in Sudan, and the wealth that comes with it. The government claims, without a whiff of evidence, that the rebels are backed by Israel.

Since launching their campaign in February 2003, the rebels have enjoyed some successes, including last year's raid on the heavily-guarded airport at El Fasher, the provincial capital of North Darfur. But their victories have brought nothing but pain to the people they claim to be fighting for, by prompting a humiliated and fearful government to arm and unleash the *janjaweed*.

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Democratic Republic of Congo

Things fall apart?

Aug 26th 2004 | GOMA
From The Economist print edition

Congo's power-sharing government starts to crumble

Get article background

Reuters

Back to the past?

TWO weeks after the massacre, something much worse may be brewing. On August 13th, 160 Congolese Tutsis were hacked to death in a refugee camp just across the border with Burundi. Tutsi politicians called it “genocide”, and cited it as proof that Congo's sputtering peace process had broken down. On August 23rd, Azarias Ruberwa, one of Congo's four vice-presidents and the country's most prominent Tutsi, announced that he and his party, the RCD-Goma, were walking out of the transitional government.

However you look at it, this is bad news. Congo's government is a fragile creature, an uneasy attempt at power-sharing involving the two main rebel movements of the civil war of 1998-2003 and the regime they rebelled against, plus a few token civilians. RCD-Goma was a Tutsi-dominated rebel army before it joined the government, armed and backed by the Tutsi-led government of neighbouring Rwanda.

Mr Ruberwa's followers have tried to allay fears that they are planning to take up arms again. From their base in Goma, on the Rwandan border, they say they are calling for international mediators: ie, South Africa, which brokered the peace deal that led to the creation of the transitional government. But many Congolese are sceptical. “I've seen this in the past. We are headed for war,” says a young man selling mobile-telephone vouchers in Goma.

The transitional government has been in trouble from the start. None of the former foes trusts each other, and none has shown much interest in actually governing, as opposed to merely using the levers of office to amass power and wealth. Ministers screech around the capital, Kinshasa, in gleaming motorcades, while the roads remain cavernous and civil servants wait longingly for their salaries.

Mr Ruberwa was the vice-president in charge of defence and security, but the president, Joseph Kabila, saw to it that he wielded little of the power of his portfolio. A parallel structure called the Maison Militaire reports directly to the president. Mr Ruberwa reportedly did not even receive daily intelligence briefings. The former rebel armies were supposed to be integrated with the national army, but many units still answer to their former bosses, and Mr Ruberwa's men complain that their ranks have not been recognised.

Nationwide elections, Congo's first proper ones, are due to be held next year. Observers fear that some of the most powerful men in government are so appalled at the prospect that they may be prepared to re-ignite the civil war to avoid it. Mr Kabila's supporters, including at least one newspaper, are speculating that war may be the only way to solve the problem of Tutsi politicians who owe more loyalty to Rwanda than to Congo.

There is still time to pull back from the brink. Some RCD members (mainly non-Tutsis) have refused to join Mr Ruberwa in quitting the government. Kofi Annan, the UN secretary-general, is appealing for more peacekeepers to be sent to eastern Congo. South Africa's president, Thabo Mbeki, is expected in Kinshasa at the end of the month to try to talk sense into all sides. Ordinary Congolese will be praying that he succeeds.

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Iraq

Sistani makes his move, maybe

Aug 26th 2004 | BAGHDAD
From The Economist print edition

Iraq's top cleric seeks to end the siege of Najaf

Get article background

AP

Venturing out in Najaf

HAVING spent the three weeks of the Najaf siege undergoing heart surgery in London, Iraq's most respected Shia cleric, Grand Ayatollah Ali al-Sistani, is returning in dramatic style. He flew into Kuwait on August 25th and crossed the border into Iraq that morning, gathering followers around him from the cities of the south. The next day, he set off for Najaf in a huge motorcade, calling on all believers to follow him. He arrived in the holy city promising to walk through the blue-tiled gateway of the Imam Ali shrine, pray, and hand the keys of the complex over to the government.

This bold tactic may not work. Mr Sistani is a retiring 73 year-old who has not been seen in public for over a year. His followers are more inclined to issue lofty declarations than to take to the streets. And Muqtada al-Sadr, the young Shia firebrand whose armed and turbulent militia occupies the shrine, has responded to the challenge by urging his followers to march on Najaf, too.

Iraq's prime minister, Iyad Allawi, has offered Mr Sadr's followers the option of ending their three-week-long uprising, turning in their weapons, and transforming themselves into a political party. However, visitors to the shrine report that Mr Sadr's Mahdi Army fighters were last heard trading stories of angels who spread palls of smoke across the sky to protect the faithful from helicopters and echoing their leader's apocalyptic pledge to “fight until the last drop of blood”.

The siege could still end without a bloodbath. Visitors report that the number of Mr Sadr's supporters around the shrine has dwindled. Some have been killed. Some may have decided that they do not wish to follow Mr Sadr as far as paradise. Others may have gone home to fight another day. Most came from outside Najaf. They, and their leader, are unpopular with the locals. Mr Sadr himself has not been seen in public for some time—the government claims that he has fled the city.

If Mr Sadr does leave the shrine, it will likely be because he feels he has no other choice. With American marines and Iraqi national guardsmen surrounding him, with Iraq's bellicose defence minister periodically vowing that a bloody showdown is just around the corner, and with a recently-convened nationwide gathering of Iraqi notables offering him peace terms that would grant him a dignified way out, Mr Sadr appears to be playing for time.

At one point, he agreed to turn the shrine over to Mr Sistani and other senior clerics, but then insisted that some of his men should remain to “protect” it. He also demanded a time-consuming audit of the shrine's treasury to prove that his men had not looted it.

Mr Sadr's followers first took control of the shrine during their first uprising in April. Before then, they had tried several times to establish a foothold inside the complex, which was previously run by custodians loyal to Mr Sistani. In addition to a tidy income from pilgrims' donations, the shrine confers immense prestige on whichever movement controls it.

Mr Sistani's march on Najaf presents Mr Sadr with a dilemma. If he were to surrender the mosque, his

stature would be diminished. But if he were to shoot Mr Sistani's followers, his claim to be the champion of devout but downtrodden Iraqi Shias would be shattered.

The government applauded Mr Sistani's initiative, though Mr Allawi may have private misgivings. On the one hand, it may end the crisis without the need for a horrifically unpopular assault on the shrine, which would also carry the risk of killing the young cleric.

That would be a disaster. So far, Sadrist clerics have restrained some of the movement's more hot-headed members, intervening to free kidnapped foreigners and discouraging the kind of terror attacks that have traumatised Baghdad and other cities. Decapitating the movement could result in dozens of Sadrist cells roaming about the south, competing with their Sunni insurgent counterparts to wreak havoc. One Mahdi Army military commander has vowed to turn dozens of suicide bombers loose on government offices in central Baghdad if Mr Sadr is harmed.

On the other hand, a successful march would probably re-establish Mr Sistani as Iraq's most influential political figure. When the Americans were still in charge, he used to wield an effective veto over political decisions, but he had remained relatively silent since the April uprisings. If Mr Sistani chooses to reassert himself in everyday politics, Mr Allawi will probably have to send emissaries to Najaf to consult with the ayatollah every time he wants to float a new initiative. The prime minister is unlikely to relish such a prospect.

Despite Mr Sistani's assertions that he does not want a role in politics, some Kurds and other secular Iraqis worry that they might just be exchanging one would-be theocrat for another. Mr Sistani may be less of a rabble-rouser than Mr Sadr, but he is equally hostile to federalism and anxious to impose an Islamic identity on the rest of Iraq, they fear. That said, it seems beside the point to be worrying about the future nature of the Iraqi state, when the most urgent task is to prevent the country from flying apart.

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Water in poor countries

A billion thirsts quenched

Aug 26th 2004 | MABUIA VILLAGE, ANGOLA
From The Economist print edition

More poor people have safe water than ever before. But why is it taking so long?

CROCODILES snatched seven people from Mabuia a few years ago. But the women of the village kept going back to the river to fetch water. They had no choice. After decades of war, the pipes in this part of Angola were broken, the reservoir was cracked and there were no generators to power pumps.

Not only was the water from the river dangerous to fetch, it was dangerous to drink, too. Aurora Jeremias, a local woman, says that three of her family have died from diarrhoea. Their plight is common. According to the World Health Organisation sicknesses caused by dirty water and poor sanitation kill about 4,000 children, globally, each day.

The good news, according to a report released this week by the UN, is that more people are getting clean water. Between 1990 and 2002, an extra 1.1 billion started to enjoy regular supplies of safe water. Some 83% of all people, up from 77% in 1990, drink clean stuff.

Every continent has improved, even Africa. Democracies and fast-growing economies, as in South and East Asia, have made the fastest progress. But even nasty dictatorships, such as Myanmar, have done better than before. In Angola, which was at war for most of the period under study, the proportion of people with access to clean water has increased from a third in 1990 to about half today.

How has this been achieved? It might be more appropriate to ask: why was this not achieved before? You do not need to call NASA to lay a water pipe. One problem is that governments have tended to declare that water should be free, so those with taps in their homes (typically the better-off) have no incentive to conserve it. Because water infrastructure has not been self-funding, it has not been extended to the poorest areas, so the poorest have ended up paying inflated prices to black-market water-sellers.

In towns, private firms can work wonders if allowed to charge something like market prices, which often they are not. In rural areas, where the poorest of the poor live, the most progress has been made by concentrating on small (and usually publicly funded) projects, such as boreholes, rather than grand dams.

Governments like starting new projects, but it is often cheaper to fix broken ones. Ideally, locals should be trained to maintain their own boreholes. Pumps can be designed to double as children's roundabouts, so that children pump water as they play. Tanks to catch rain are simple and efficient.

In Mabuia, the poorest residents pay a few cents each week for water and a communal shower block. Richer ones pay extra for taps in their homes. The sums raised pay for an engineer to live in the village and fix its pipes. And Mrs Jeremias's six children are now healthy and in school.

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A robot interpreter

Elevate your hands or I ignite

Aug 26th 2004
From The Economist print edition

A high-tech weapon for the war to win Iraqi hearts and minds

AMONG the many fields in which Americans excel are technological wizardry and not speaking foreign languages. So it was only a matter of time before someone invented a robot that can translate spoken English into other tongues. Enter the “Phraselator”, a palm-held electronic polyglot built by a firm in Maryland called VoxTec. Its most immediate application is military. Flesh-and-blood linguists prefer to work in places where their flesh and blood are safe. Robots don't care.

Humans may be better interpreters than machines, but they “often have their own political agenda”, which can jeopardise accuracy, says the Phraselator's designer, Ace Sarich. Plus, at $2,300 a pop, the device works out cheaper than an interpreter's wages, especially if you expect to be stuck somewhere foreign for a long, long while. So it's popular with coalition troops in Iraq.

The seed money for the Phraselator was supplied by the American government. After September 11th 2001, the Department of Defence decided it was going to need a machine that could speak Arabic, among other languages.

Shawn Collins, a sergeant with America's special forces in Iraq, calls the device “a godsend”. After a recent battle, he found he was able to make a group of Iraqi children laugh with his Phraselator's Star-Trekky vernacular. He then asked if they knew of any hidden weapons nearby, and they led him to a cache of rocket-propelled grenades.

For now, the device is best at translating phrases “commonly used by soldiers”, says VoxTec. But the company is exploring new markets, including disaster relief, tourism and the preparation of Freedom Fries. “We've been approached by fast-food companies that need to tell [non-English-speaking] workers how to use the deep-fat fryer,” says Mr Sarich.

The Phraselator's main drawback is that it cannot translate replies. Questions have to be answerable with a nod of the head, or by pointing to the window where the sniper is lurking. It lacks a certain human touch, too. “Pointing a machinegun at enemy soldiers and yelling loudly in English and motioning them to get down tends to work wonders compared to pulling out the Phraselator and having it say: ‘Drop your weapon',” says Sgt Collins.

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France and its Muslims

A hot rentrée?

Aug 26th 2004 | PARIS
From The Economist print edition

The start of the school year will rekindle France's impassioned debate about the Muslim headscarf

Get article background

WHEN French schoolchildren return next week for the first day of the new term, anxious parents will not be the only ones watching carefully at the gate. The start of the school year brings into force a new law, approved earlier in the year, to ban the Islamic headscarf in state schools. The government has promised to clamp down firmly on any pupils who flout it. Yet defiant Islamic groups are calling on Muslim girls to do just that.

When President Jacques Chirac decided last year to push through a law banning “conspicuous” religious symbols and dress in state schools, he hoped to end the confusion about what was allowed, and what not. The original 1905 law that separates church and state, whose 100th anniversary falls next year, was designed to protect schools from religious interference. But whereas that entrenchment of secularism was aimed at the Catholic Church, the recent quarrel has been with Islam.

France is home to Europe's biggest Muslim population, some 4.5m-strong, and a growing number of young girls have taken to wearing the headscarf. Until now, religious symbols in state schools have not been forbidden, so long as they are not “ostentatious”. By hardening that word to “conspicuous” in the new law, and explicitly naming “the Islamic headscarf, the kippa or a crucifix of manifestly excessive size”, the government had hoped to end the argument once and for all.

Not if some groups have their way. Even before the holidays, the Union of French Islamic Organisations (UOIF), a hard-talking lobby group, had called on all Muslim girls to “turn up to school in the dress of their choosing”. The new law, it judged, does not forbid all religious symbols, nor even all visible religious symbols, so there is room for negotiation. The UOIF will support, both morally and legally, any schoolgirl who gets into trouble at school over the headscarf.

A showdown seems likely. François Fillon, the centre-right education minister, has promised to be uncompromising in applying the law. “I will personally keep watch, there will be no exception, the republic will be firm,” he has declared. He has also distributed to schools a brochure called “The Republican Idea Today”. It is designed to explain in simple terms such notions as secularism or anti-Semitism (last weekend a Jewish community centre in Paris was burnt down, the latest in a string of anti-Semitic attacks across France, many of them blamed on Muslim youths). The brochure consists of essays by sociologists, philosophers and other intellectuals. The point is to reinforce the idea that the

headscarf ban is not aimed at Islam, but reflects broad French principles and traditions.

In theory, there are clear guidelines about what schools should do if the law is flouted. Before suspending or expelling a child, schools must undertake “dialogue” with the pupil, to educate her about secularism. This phase is not, the rules make plain, a time for negotiation. But some Muslim groups are preparing to intervene at this point on behalf of pupils. In a bid to avert trouble, Dalil Boubakeur, the leader of the French Council for the Muslim Faith (CFCM) and rector of the Paris mosque, has called on them to be “careful”.

If confusion prevails, this could be what some people want. The conviction among some French officials is that the headscarf row is part of an organised plan by radical Islamic groups to secure a stronger position in France. “They want to use the headscarf ban to create disorder, and promote themselves,” says one. Further demands will follow, such as dispensation for Muslim girls from gym or science lessons. This analysis suggests that many Muslim girls who wear the headscarf do so not for reasons of religious conviction or even teenage rebellion, but under pressure. The ban, and the problems enforcing it, may just be valuable publicity.

The saga has also exposed the risk that the government took when it created the CFCM as an official voice for French Islam. Although the cautious Mr Boubakeur is, for now, its head, harder movements swept elections to its regional branches. The argument was that bringing groups such as the UOIF inside the system would make it harder for them to work against it. But unity has been short-lived. On behalf of the CFCM, Mr Boubakeur has called for the headscarf ban to be respected. The UOIF has broken ranks to defy it. To outsiders, it may look like a fuss over a hairline. To many in France, it is a test of the republic's ability to integrate radical Islam.

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Germany

Trust but verify

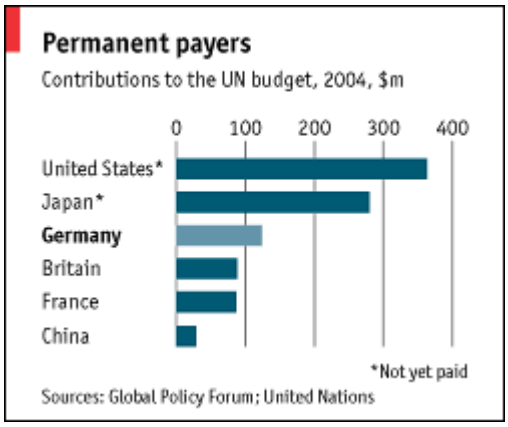
Aug 26th 2004 | BERLIN
From The Economist print edition

Two debates on whether it is safe to give the German people more of a voice

CAN the world trust Germany, and can Germans trust themselves? Nearly 60 years after the second world war, such questions must seem almost insulting. Yet Germany is still not a permanent member of the United Nations Security Council. And it is one of the few big democracies not to allow referendums. Now change is in the air on both fronts. The German government is campaigning hard for a permanent Security Council seat. And, after the British and French decisions to hold referendums on the European Union constitution, the pressure is building for Germany to follow suit.

Neither issue is new. Ever since reunification, German governments have expressed interest in being on the Security Council. But even Chancellor Gerhard Schröder, who thinks Germany is a big country that should be treated as such, has not pushed hard. Yet now that the idea of a common seat for the European Union is receding, he is more insistent on one for Germany. His foreign minister, Joschka Fischer, is lobbying around the world.

Calls for referendums have also been made before, for instance to approve German reunification. But they ran into the post-war consensus against such consultation, after Hitler's exploitation of populism. Only now has it sunk in that it was not referendums that paved the way for Hitler—there were only two during the Weimar Republic. Today, politicians are more fearful of being seen to mistrust the people: 81% of Germans say they want a referendum on the EU constitution.



So what are the chances of either change happening? Germany has a good case for a permanent voice among the world's powers. Only America and Japan contribute more to the UN budget than Germany (see chart). Japan is also lobbying for a place at the top table. And, with 8,600 soldiers now on duty across the world, Germany is also among the leading contributors to UN-mandated missions. Yet such figures count for little in the power struggle over UN reform.

Instead of new permanent members, the panel working on UN reform seems to want a new class of semi-permanent members, elected for five years, a solution that would not satisfy Germany. What is more, some permanent members are not keen on Germany joining them. France and Britain are said to be in favour, but probably only to fend off demands to turn their seats into a single EU one. The Italians are against there being a seat for Germany, but not for Italy. More important, Germany's recent actions as a non-permanent member are seen in Washington as unhelpful, not just on Iraq but also over such issues as the International Criminal Court.

Referendum enthusiasts will also have to be patient, not least because they do not form a united front. Some, such as the Free Democrats and Bavaria's Christian Social Union, want only a referendum on the EU constitution. Others, mainly the Social Democrats and Greens in the ruling coalition, are in favour of more direct democracy, but not for foreign-policy or EU matters. Such differences will make it hard to get the necessary two-thirds majority in both houses to change the constitution to allow referendums. Mr Schröder, who is against a referendum on the EU constitution, will push parliament to ratify it fast, so as to show the way for the rest of Europe. The government also plans a bill that would allow referendums on pending legislation, but this bill is no likelier to pass than a previous one.

Even if any proposed changes come to naught, the debate on both issues suggests that German

democracy is maturing. But it is perhaps not yet as deep as it should be. Some critics denounce demands for a place on the Security Council as “left-wing nationalism” and a shift away from European integration. Meanwhile proponents avoid all the hard questions. Would a permanent seat not entail spending more on defence, and sending soldiers on real combat missions?

Similarly, those in favour of referendums do not look far enough ahead. Allowing a referendum on the EU constitution might make it hard to refuse one on Turkey's EU membership. And what if voters blocked structural reforms, such as the labour-market changes against which they are protesting in the streets? Too much consultation can be as dodgy as too little.

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Russian air crashes

Coincidence or terror?

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Two near-simultaneous plane crashes look worryingly like renewed terrorism

EPA

TWO passenger jets, after taking off from the same airport, reach the safety of cruising altitude, then disappear from radar only three minutes apart and crash. Coincidence? It seems impossible. Yet so far there is no hard evidence of what caused the crashes on August 24th. Some witnesses report hearing one plane explode. The crew of the other sent a distress signal, but contrary to initial reports this was not a hijack alert. Until investigators have examined the remains and analysed the black boxes, Russia will be gripped by uncertainty.

It is a particularly painful uncertainty. If the cause was pilot error or mechanical failure—one theory blames the use of low-quality fuel—nobody will ever feel safe again in the elderly Tupolev aircraft that form the mainstay of Russia's domestic (and some of its international) fleet. The combined 89 deaths make these Russia's worst civil-aviation accidents in three years. But both planes, claim the airlines, were in good condition; and unprovoked accidents at cruising altitude are extremely rare.

If these were terrorist attacks, a different fear reawakens: that terrorism is once again leaving the confines of Chechnya. After the October 2002 rebel raid on Moscow's Dubrovka theatre, in which 120 or more hostages died after security forces pumped in gas before storming the building, a spate of bombings hit Moscow, including one on the metro that killed more than 40 people. There were fears of a concerted terrorist campaign, though many saw heightened security chiefly as an excuse for the police to extract more bribes.

But then the attacks subsided—until this week. The day before the crashes, a bomb exploded at a Moscow bus stop. If terrorists managed to slip through the security at Domodedovo, Russia's best-run airport, then Russians will wonder whether the impressive security trappings of what increasingly resembles a police state are worth anything at all.

Fears of terrorism have been stoked by the imminence of this weekend's presidential election in Chechnya. Aslan Maskhadov, a Chechen rebel leader, has said he was behind a daring raid in Ingushetia in June and that more was to come. But so far, neither Mr Maskhadov nor anyone else has claimed responsibility for the crashes. Even the authorities, usually quick to blame the Chechens for anything that smells of terrorism, are holding back. Russians must wait to learn the truth—though few believe the government will give it to them.

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The pope

The pilgrim looks east

Aug 26th 2004 | ROME
From The Economist print edition

Although an ailing pope may never visit Moscow, an icon goes before him

Get article background

Reuters

Preparing his goodbyes

THERE have been many signs recently that Pope John Paul II may be nearing the conclusion of his earthly journey. The latest was given by the man himself, during a visit to Lourdes, in south-west France—one of the places associated by Catholics with the healing powers of the Virgin Mary, who has always played a central role in the pontiff's personal piety.

Visiting the grotto on August 15th, the 84-year-old pope, who had obvious difficulty speaking and breathing, told a crowd of 200,000: "I end my pilgrimage here." A Belgian cardinal, Godfried Danneels, called it "almost his goodbye to Lourdes and maybe also to his life".

There is another indication that the pontiff is preparing for the end: his increasingly determined push for reconciliation between Roman Catholics and Orthodox Christians, who have been formally divided for almost a millennium. As an eastern European, he is particularly sensitive over this issue. He must also realise that there is little chance of his successor—who may be Italian, Latin American or possibly African—giving it similar priority.

The impression in Rome is that the pope is doing as much as he can to repair relations with the east while his strength holds out. One of the most warmly received visitors to Rome this summer was Patriarch Bartholomew, the Istanbul-based prelate who by tradition is the "first among equals" in the eastern Orthodox hierarchy—and who has often risked the ire of his fellows by keeping relations with Rome cordial. With an alacrity that impressed the patriarchal party, the pope agreed to pay a return visit to Istanbul in November. This trip to the see of "Constantinople and New Rome"—to use its ecclesiastical title—is one of the few journeys still left in the papal diary.

What about Moscow, which after the fall of Christian Byzantium in 1453 proclaimed itself the Third Rome? It seems unlikely that the pope will ever realise his ambition to go there. But another traveller—and as the pope would see things, a more important one—was en route from Rome to the Russian capital this week.

The icon of Our Lady of Kazan, which first appeared in the 16th century, is credited with working momentous miracles on behalf of the Russian people, including the rout of several invaders. And a work of religious art which is—at the very least—one of the oldest and most prized copies of the original Kazan icon was being brought to Moscow by a Vatican delegation in time for August 28th, an auspicious day when Russians mark both the "falling asleep" of Mary and the end of summer.

To the alarm of the Moscow church hierarchy, the Vatican originally mooted the idea of trading the return of its Kazan icon for a papal visit—something the Orthodox Church has opposed so long as disputes over the "poaching" of worshippers in Russia and elsewhere remain unresolved. In another diplomatic move, Vatican officials toyed last year with returning the icon to the autonomous Russian republic of Tatarstan, of which Kazan is the capital—thus bypassing the authorities, both political and ecclesiastical, in Moscow.

Instead, Our Lady of Kazan will simply be handed over—with no apparent strings attached—to Alexy II,

patriarch of Moscow, by Cardinal Walter Kasper, a German who handles the Vatican's relations with other Christian denominations. As though to reassure people that he has not gone soft, the Russian patriarch has stressed that, since the icon in question is only a copy, there was no need for the pope to bring it in person. But a warmer breeze is blowing in Russian-Vatican relations. After much delay, the Russian state has just accorded legal recognition to the Catholic diocese of Saratov in southern Russia.

Church politics aside, this has been a summer of happy surprises for the Russian Orthodox faithful, for whom images of the Virgin Mary are among the precious and tangible tokens of holiness on earth. In July another of Russia's most prized icons—the Tikhvin Mother of God—was returned to a monastery near St Petersburg, amid great public rejoicing, by a Russian-American cleric who had kept it for half a century in his modest home near Chicago.

As the pope bade an emotional farewell to a Kazan icon that has adorned his wall for the past 11 years, he seemed to be sending a subtle signal: that, although horse-trading and summit diplomacy will not bring western and eastern Christians together, the Mother of God and her prayers for humanity just might. On that point, even his sternest Orthodox critics have no choice but to agree.

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Italy and former Yugoslavia

Memento mori

Aug 26th 2004 | ROME
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A new diplomatic row about an old piece of barbarism

GRIEVANCES run deep in Europe. Nowhere more than between the old European Union of 15 and its new, ex-communist members. Witness a row over a television series that has not even been completed. “Il Cuore nel Pozzo”, being shot by the Italian state-owned RAI network, recalls a particularly barbaric episode. Between 1943 and 1947, thousands of Italians were dragged from their homes by Yugoslav partisans, often tortured, bound hand-and-foot and tossed (sometimes alive) into deep chasms known as *foibe*. The killings occurred in and around the Istrian peninsula, which fell to Italy at the end of the first world war but was lost to Yugoslavia after the second. Before the partisans came, the peninsula was brutally “Italianised” by Mussolini's fascists.

If all this brings to mind ethnic cleansing, that may also explain the response in ex-Yugoslavia. The RAI project has been criticised in the Serbian and Croatian media. Slovenia's foreign minister, Ivo Vajgl, was quoted by an Italian news agency as seeking an explanation why a “para-state institution” is making a series that is “a provocation and offence to the Slovenian people”. “Let him go ahead,” retorted Italy's telecommunications minister, Maurizio Gasparri. “The truth is the Slovenes are not prepared to see this issue confronted.”

Critics see the RAI series as part of plans by Italy's conservative government to rewrite history. Mr Gasparri's National Alliance party has its roots in fascism, after all. But in this instance history needs correction. The murders of so many Italians were ignored after 1947 for reasons of cold-war diplomacy. Italian governments did not want to upset Yugoslavia, whose independence from Moscow offered a buffer against the Soviet block. The Communist opposition was not eager to draw attention to a shameful page in Communist history.

Those days are now over. In February, an Italian parliamentary motion to declare a day of commemoration for the victims passed by an overwhelming 502-15, and even won support from the formerly communist Democrats of the Left. As the party's leader, Piero Fassino, said: “The crimes committed by the fascists in Istria cannot be denied. But they do not justify...the *foibe*.” Quite.

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Hungary

Revolving doors

Aug 26th 2004 | BUDAPEST
From The Economist print edition

A new prime minister steps up

AFP

Gyurcsany, atop the greasy pole

TO BE a prime minister in central Europe remains a precarious job. The Czech Republic and Poland have both shed theirs this year (only this week did the new Czech prime minister, Stanislav Gross, win a parliamentary vote of confidence). Now Hungary's Peter Medgyessy has stepped down, after being stabbed in the back by his one-time protégé, Ferenc Gyurcsany, a multi-millionaire turned champion of the poor. As if to rub salt in the wound, on August 25th the ruling Socialists selected Mr Gyurcsany to take Mr Medgyessy's place.

Mr Medgyessy, a former Communist spy and international banker, was an anomaly in the rough and tumble of Hungarian politics. He was not even a member of the Socialist Party. He presided over a coalition government with the Free Democrats, a liberal party founded by former anti-Communist dissidents. Despite his racy past, Mr Medgyessy came across as austere, even a bit dull. He never looked comfortable when campaigning. Yet for many voters his steady-hand-at-the-tiller approach was appealing after the confrontations that marked the previous government of the conservative Fidesz party.

Mr Medgyessy was well-regarded abroad. He sent Hungarian troops to Iraq, a brave decision that brought him little popularity at home. Indeed, voters deserted the Socialists in Hungary's European elections, giving them only nine of the country's 24 seats, while Fidesz took 12. Opinion polls showed support for the Socialists plummeting. One survey of young people gave Fidesz over 40% support, twice as much as the Socialists. With elections only two years off, the Socialists had a big problem on their hands—and an incentive to dump Mr Medgyessy.

The ostensible trigger was the sacking of the Free Democrat economics and transport minister, Istvan Csillag. The Free Democrats refused to accept the decision. Mr Medgyessy threatened to resign to get his way. To general surprise, the Socialists accepted his resignation and produced two candidates for the succession. The party leadership favoured Peter Kiss, the deputy prime minister. Mr Kiss is able but dull, widely mocked in the press as a youthful version of Brezhnev.

The party congress accordingly swung away from Mr Kiss and heavily backed Mr Gyurcsany instead. Although a former leader of the Communist youth league, he is a slick and ambitious 43-year-old who seems to model himself on Britain's Tony Blair. He made his fortune out of privatisation deals in the early 1990s, helped by connections by marriage to one of Hungary's leading Communist-era dynasties—though he fiercely denies having done anything illegal or even to be ashamed of.

Mr Gyurcsany's arrival as prime minister will, it seems, ensure that the coalition government survives for a while longer. The financial markets remain nervous—and they would be more so if Mr Gyurcsany were to replace Tibor Draskovics as finance minister. The Socialists' Free Democrat partners have taken a battering after corruption scandals. In an emotional television interview Mr Medgyessy attacked his former allies, declaring that much remains untold about their business machinations. Yet the Free Democrats remain stuck with their coalition allies.

One person who seems to have got off lightly in all this is the Socialist Party chairman and foreign minister, Laszlo Kovacs. Although he originally backed Mr Kiss, Mr Kovacs personifies the old joke about

a Hungarian being someone who enters a revolving door behind you, but comes out in front. In the 1980s a communist, in the 1990s a democrat, Mr Kovacs is now being reborn as European Commissioner in charge of energy, as well as a backroom influence on the government. Chameleons fare best in Hungarian politics.

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Correction: Pascal Lamy

Aug 26th 2004
From The Economist print edition

In our August 21st story on the new European Commission, we attributed remarks about the likely direction of the EU's trade policies to the present trade commissioner, France's Pascal Lamy. In fact the comments were made by an anonymous commission official, and not by Mr Lamy. Sorry.

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Stress

Never a dull moment

Aug 26th 2004
From The Economist print edition

Work is safer. But workers now complain of new ailments such as stress

WITHOUT at least a touch of stress, a job may be rather boring. Yet an increasing number of workers find stress not a welcome buzz but an offence perpetrated by their employers. In Britain, days lost to stress, depression and anxiety increased from 6.5m in 1995 to 13.4m in 2001-02. In the past year alone, over half of all employers saw increased absenteeism due to stress, according to the Chartered Institute of Personnel and Development.

Stress is a hot topic in many developed countries. In France, a new bestseller called *Bonjour paresse* ("Hello laziness") provides one response: keep activity to a minimum and lie low. That's amusing, but not great for productivity. Preventing people from becoming stressed means providing expensive helplines and hiring even more expensive counsellors. That's bad enough. Making stressed workers turn up to work is difficult too. And if they can be coaxed or cajoled into work they may sue if they feel their employer hasn't taken their ailment seriously enough.

In Britain, stress has attracted the attention of the government. Before he set off on holiday, Tony Blair chaired a discussion in his Downing Street offices on balancing work and life outside it. The Health and Safety Executive (HSE), which has done a good job of making sure people do not get mangled by machines at work (see chart), is now trying out guidelines to save workers from the horrors of stress. They will be issued to companies in November.

Worrying about work is preferable to being physically endangered by it. In this respect, more stress is good news. Eric Teasdale, chief medical officer at AstraZeneca, says that when he started out in occupational medicine in 1976, workplace illness meant nasty diseases caused by asbestos, deafness from noisy machinery and skin problems caused by spilt chemicals. Those problems have mostly been replaced by more cerebral complaints.

But stress is a fearfully woolly concept. “When we started looking at stress,” says Elizabeth Gyngell of the HSE, “we thought we might be able to say that three and a half inches of paper in the in-tray was too much.” In fact, it has proved much harder than this for the HSE, or anyone else, to pin down. Like depression and other mental illnesses, stress is subjective. Unlike depression, though, there is no clinical definition of stress, so there is little danger of misdiagnosis. It is also circular. “A person might complain of being stressed and likewise blame it on their stressful job,” says Simon Wessely of King's College, London. Stress is both a handy concept, and a limitless one.

For all the difficulties in describing it, there could still be something going wrong in the workplace. But the explanations of increased stress bear little scrutiny. The first of these is that working longer hours causes stress. But hours worked have been in long-term decline—in the mid-19th century the average was 60 hours a week; they have also dropped recently. Long hours mostly affect British men: four out of five of those working 48 hours or more per week are male. Yet between 1997 and 2002, the percentage of men doing this dropped from 35% to 30.7%, according to the labour-force survey. A second theory holds that innovations in communications and increased surveillance of workers have made life more stressful. Derek Sach, president of the London Chamber of Commerce and Industry, says that “stress and sickness have undoubtedly increased as the internet and mobile phones have quickened the pace of life in the workplace”. That might be plausible if it had not been heard before. In the 1870s a doctor called George Beard identified a new group of neurotic disorders caused by the pressures of advanced civilisation. “Neurasthenia” was, he said, caused by a speeding up of life due to the railway, the telegraph and the press that combined to sap reserves of “nerve force”. Mr Wessely thinks that the causes of now forgotten neurasthenia closely resemble those blamed for stress.

What has changed is the readiness of workers to say they are stressed. That's self-reinforcing: information on the prevalence of stress is collected through surveys. But the more people are asked whether they are stressed, the more willing they are (see chart) to say yes. Philip Hodson, of the British Association for Counselling and Psychotherapy, reckons this is part of a natural process: as people get richer, their sense of entitlement to happiness increases and their threshold for worry often becomes lower. Stress, unlike, say, inadequacy, also has few negative connotations, making it painless to acknowledge. “Stress can almost become a badge of honour,” says Mr Teasdale.

So what should companies do to beat it? The HSE's stress guidelines are probably not the best starting point. The latest draft includes some rum notions: 65% of the workforce, for example, should feel that their employer “engages them frequently” in organisational change. In fact, many companies already know that keeping workers happy can save money. AstraZeneca, which runs various programmes to increase the wellbeing of its workforce, reckons it saves £210,000 ($380,000) annually in lower insurance premiums.

The advantages of having happy and productive workers are likely to push other companies the same way. Given the vagaries of stress, preventing it by regulation is as impractical as trying to legislate against tiredness or, for that matter, boredom.

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Naturalisation

Shonky poms

Aug 26th 2004
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Do Australians speak English? Not according to the government

FOREIGNERS wanting British citizenship must know English. But what if they've been speaking it all their lives? The government is in a tangle over how to apply new naturalisation rules to applicants from countries such as Australia. Foreigners who have learnt English must take tests. But those from English-speaking countries are to be certified by a responsible person such as a judge, teacher or elected official.

A global language

New Zealand:	Britain:
Hoon	Hooligan
Kai	Food
Shonky	Unreliable
Australia:	
Skivvies	Underclothes
Thongs	Flipflops
Chunder	Vomit
Canada:	
Hoser	Oaf

Source: *The Economist*

English dialects, including foreign ones, do have their peculiarities (see table). But they're none the worse for it: of the last 20 Booker prize winners, only eight have been British.

For many of the applicants concerned, the very idea of having to prove that they speak English has an unpleasant whiff of colonial condescension—especially given the less-than-perfect English they find spoken in Britain. Newspapers in Australia and New Zealand have mocked the new rule. No other English-speaking country insists on a language test for would-be citizens with British nationality.

Even more annoyingly, the government has bungled the details. Although the new rules have been in force for some weeks, the procedures for English-speaking applicants are not yet decided. What, for example, is meant by a “designated teacher”? A native-speaker could end up being certified by someone less fluent. There's no rule that local councillors, for example, must speak English at all; at least one, in Manchester, uses an interpreter.

The government is unapologetic, pointing out that the delay affects only people already settled in this country who want to apply for citizenship. They can wait a few weeks longer without inconvenience, a Home Office spokesman argues. Maybe so. But the new rule still seems odd: once in force, it will be open to abuse, while inconveniencing a desirable bunch of would-be citizens for no good reason.

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Labour market

A gap filled

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The new Europe is easing British labour shortages, slowly

SHAMROCK TRAVEL, a Welsh coach company, used to find it hard to recruit drivers. Unsociable hours meant that local workers' attendance was unreliable. That has changed since the firm hired 70 drivers from Malta, Lithuania and Estonia. They are not only friendlier than the locals they replaced, but more reliable too. Clayton Jones, Shamrock's boss, says he has never received so many letters praising the quality of customer service; the number of sick days taken has fallen by half since May.

That was the month when ten new members joined the European Union (EU) giving 75m people the unrestricted right to seek work in Britain, while most other EU members continued to impose restrictions and quotas.

This was very controversial. Immigration and asylum are a hot political issue. This week, for example, the government boasted that the numbers seeking asylum had dropped again, while dodging charges that it had manipulated the figures. But the real news on this subject is that the waves of east European migrants supposedly flooding into Britain have proved to be no more than a useful trickle.

Companies that want to recruit workers from the new EU member countries are having to work hard at it. Shamrock Travel, for example, arranged accommodation, language training, registration paperwork and medical check-ups for the new employees. It also sorted out school places for their children and social introductions for the families. It employs a full-time welfare officer to look after them.

Other employers use recruitment agencies. Grafton Recruitment, which specialises in Poland, has placed 200 people since May, with excellent feedback from clients, it says. Top Staff Employment, an agency based in Scotland that recruits Latvians for the catering and construction industries, is planning to expand to neighbouring Lithuania and Estonia.

For the many east Europeans already working in London, either on student visas or illegally, prospects have become markedly better. At Tastebuds Cleaning in London, where 90% of the staff are Polish, the boss, Alison Vicary, says that Poles will benefit now that they can work full-time and be promoted to management jobs.

A small trend, then, but likely to rise. Britain's economy will benefit. But locals lacking similarly marketable skills may find life just that bit harder.

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Contempt of court

Can't say, won't say

Aug 26th 2004
From The Economist print edition

Foreigners are better informed about English anti-terrorism trials than locals

TERRORISM and the fight against it are of enormous public interest. But contempt of court laws, designed to protect potential jurors from preconceptions about the case, mean that people living in Britain know much less about local anti-terrorism trials than those living abroad.

This week, eight suspects appeared at the Old Bailey, London's central criminal court, for preliminary hearings on terrorism-related conspiracy charges, including seeking to use radioactive materials, chemicals, toxic gases and explosives. That's the first time since September 11th 2001 that any concrete charges have been brought publicly linking suspected terrorists with the technology of mass destruction. There's plenty to report, not solely about this case. But under English law, coverage and comment are tightly restricted until trials end.

In other countries, journalists covering court proceedings can largely write what they like. Foreign journalists do just that, even when covering British trials. In recent days the *New York Times* has been gaily publishing sensational allegations by American intelligence officials, regarding past terrorist activities in the United States, which relate to a trial currently under way in England. But readers of the British press will hear nothing about this until the case is over. They may at best read the bare bones of the case as laid out in court such as the names of the defendants and the nature of the charges against them.

Do such rules make sense? In other countries with looser laws, juries work fine. Besides, foreign papers can be freely bought on British news-stands in big cities, or seen anywhere on the web; satellite and cable carry American news channels. The attorney-general's office, which enforces the contempt law in England and Wales (Scotland has a different legal system), says that it is a matter of degree. A banner headline about a suspect in a British tabloid is far more likely to prejudice a potential juror than an article in foreign media.

Patrick Tyler, the *New York Times* bureau chief in London, says he was not even aware of Britain's contempt of court rules. He certainly did not heed them in recent coverage, which *The Economist* is not able to describe directly: “I just don't see what such rules have got to do with it all. US officials have flagged the importance of this case. We've got a terror alert on that could disrupt our presidential elections. We've got to report this stuff.”

But the British authorities think things have gone too far already. The attorney-general, Lord Goldsmith, berated journalists in a speech last year. A “disturbingly high” figure of more than 70 contempt of court cases in the past 12 months had been sufficiently serious to warrant his investigation, he said.

Lord Goldsmith is regarded as being much tougher on the press than most of his predecessors. In a case in 2001, for example, involving two footballers charged with assault, the *Sunday Mirror* was fined £75,000 ($108,000). It had published an interview with the victim's father during the jury's deliberations, which caused the collapse of the trial, at an estimated cost of £8m. The paper's editor promptly resigned. But such fines may not be enough when compared with the sales tabloid newspapers can gain with such reporting. The only real deterrent, argue civil-rights lawyers like Helena Kennedy, is to imprison editors. That is possible in law, but hasn't happened for over 50 years.

As the distinction between home-grown and foreign news blurs, even such draconian sanctions won't protect the contempt of court laws for ever. Lord Goldsmith may thunder all he likes, but people like their news now, rather than later.

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Compensation culture

Inadmissible evidence

Aug 26th 2004
From The Economist print edition

A misguided attack on a real problem

DAVID DAVIS, the shadow home secretary, probably reckoned he could not fail. Last week he assailed both European human rights law—anathema to the right-wing press—and the "compensation culture", both of which he blamed for risk-averse behaviour that makes life dull and expensive. As if to underline his point, news emerged that an annual barrel-rolling contest in Devon had been cancelled after insurers deemed it "dangerous"—just the sort of footling, kill-joy objection that riles fun-loving public opinion.

But two populist causes do not make even one good one. The government brushed Mr Davis aside by pointing out that neither the value of claims nor the volume of litigation have increased much recently: last year, accident claims actually fell by 9.5%. As for the 1998 Human Rights Act, which the Conservatives have pledged to review, that has led to only a tiny increase in lawsuits. Martyn Day, a personal-injury specialist, says that he invokes the act in perhaps three in a hundred cases, and then only as an "add-on".

Mr Davis's wayward aim is regrettable because the target is important. Defending, and hence insuring against, personal-injury lawsuits has indeed become much more costly in the past decade. But that is mostly thanks to legal reforms initiated by, er, the last Conservative government.

Accident lawsuits, which used to be funded by the taxpayer through legal aid, are now virtually all fought on a no-win, no-fee basis. That is right—under the old system, there was little incentive for solicitors to turn down hopeless cases—but it has raised costs. Unsuccessful defendants are now liable not only for damages and the other side's legal expenses; they must also fork out a "success fee" and reimburse the winner for any insurance they might have taken out against losing. As a result, £10,000 ($18,000) in damages often means a payout of more than £15,000.

Even more unnerving than rising costs is the fear of litigation itself, which is making local authorities overly risk-averse. As Mark Harvey, of the Association of Personal Injury Lawyers, puts it: "There really isn't a compensation culture. But there's a perception that one exists, and that is causing problems." Too true: the timidity and inaction it creates in officialdom, schools, businesses and the voluntary sector are a modern curse. But that's all the more reason for politicians to get their facts right.

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British Airways

Absent friends

Aug 26th 2004
From The Economist print edition

The nation's flag-carrier flies into its usual summer crisis

Get article background

AFTER a summer of disasters, this holiday weekend could make or break British Airways' reputation. The airline carries over 100,000 passengers a day at this peak time of year. But it has had difficulty coping with them. On Monday and Tuesday it cancelled some 80 flights, leaving hundreds of passengers stuck on the ground. On Wednesday a further 14 flights were cancelled as newspapers, headline-hungry in the summer news famine, were full of stories of suffering passengers and chaos at Heathrow. Heavy rain, air-traffic delays and technical problems all contributed, but the underlying cause was (as ever) BA's bad labour relations.

News in past weeks has been bad too, chiefly about a threatened strike by ground staff. That was averted last week only after an expensive 8.5% pay increase, phased but still more than the airline can afford. By the time the deal was done, many passengers had crossly made alternative arrangements to avoid being stranded.

That echoed last summer's high-season fiasco, when check-in staff staged lightning strikes in protest at having to use electronic cards to log on for duty. That dispute cost the airline £40m in lost revenues, and hurt its reputation.

The dreadful news coverage around all this disguises the fact that BA is actually one of the world's more successful carriers. Its bumptious slogan about being the “world's favourite airline” became outdated when Lufthansa overtook it recently in terms of international traffic. But BA reacted to the aviation slump that followed the terrorist attacks of 2001 by slashing capacity and costs: some 13,000 jobs have gone and more cuts are on the way. Its latest financial results show an operating profit of £150m in the three months to the end of June; most of its competitors are struggling with losses.

According to Chris Tarry, an aviation consultant, BA has made substantial progress, reflected in these financial results. But it still needs to cut some £100m-£200m from its wage bill. BA has admitted that it was slow to recruit some 200 extra ground staff to replace some of those who have taken voluntary redundancy. But it would not need any new staff at all, if those already on the payroll could be relied upon to turn up for work. At one point BA was even offering a £1,000 bonus for staff who took fewer than ten days off sick. Current absenteeism rates show a startling 17 sick days a year, two-and-a-half times greater than the private sector figure.

But it wasn't just absenteeism that left BA short of about 10% of the workforce it needed at Heathrow this week, tipping the system into chaos. It is almost beyond belief that BA managers failed once again to see this peak season crunch coming, and take avoiding action. Now managers and other back-office staff must fill the gaps at the check-ins. About time too.

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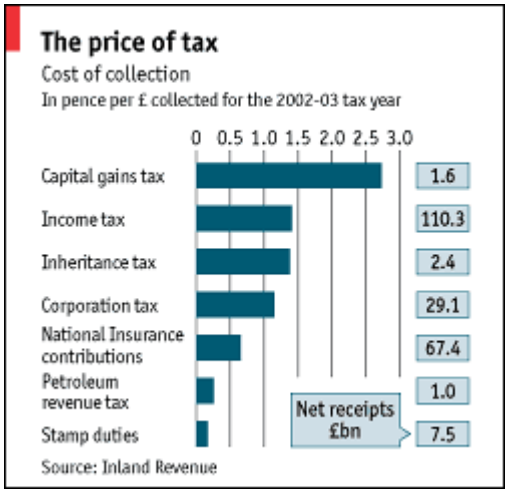
Inheritance tax

It just won't die

Aug 26th 2004
From The Economist print edition

Inheritance tax offends many principles. Bury it

INHERITANCE tax is supposed to clobber the super-wealthy. But it does nothing of the kind. Rising house prices and good tax accountants have made it a largely voluntary tax on the honest, careless or unlucky middle classes. One former chancellor of the exchequer, Roy Jenkins, said it was paid only by those who distrusted their relatives more than they disliked the taxman.



The really rich hardly pay it at all. They use clever mixtures of gifts, trusts, offshore companies and dodges such as “die-to-win” life insurance to keep the money in the family. Though only 3.9% of all estates paid the tax in the 2001-02 tax year, well over half of those were worth less than £500,000. Those who are really caught are middle-class property-owners in London or the south-east. They aren't used to tax-dodging and their houses have shot up in value in recent years.

Orthodox taxation principles would suggest that the rate be cut and the base broadened to raise legitimacy and compliance. But a Labourite think-tank, the Institute for Public Policy Research, has suggested something different. Instead of the present 40% levy on estates worth more than £263,000, it proposes a graduated rate, starting with 22% for the first £25,000 over the tax-free allowance and going up to 50% for the part over £763,000. That, supposedly, would mean 87% of all estates paying less tax and bring in an extra £147m pounds in revenues, shaved exclusively off the rich.

That might happen. But higher rates also stimulate avoidance. In any case, reaction was frosty and the government has not endorsed the plan.

It is a tempting route, though, given the huge and unearned increase in house prices enjoyed by the middle class. Taxing dead people rather than the living sounds fair (though heirs, who pay the tax, disagree). But inheritance tax has big disadvantages. Although not very costly to administer (see chart: that prize goes to capital gains tax), it distorts spending patterns, encouraging consumption over savings, and stimulating investment into exempt assets like farms and family businesses. And it fuels the tax-avoidance industry, which uses brains better employed elsewhere.

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Floods

Fog about floods

Aug 26th 2004
From The Economist print edition

The political and economic geography of inundation

THIS August has been the wettest for 50 years. Rainfall is 77% above average. The harvest lies rotting in the fields, and floodwaters have made several towns look like parts of Venice, or worse.

Flooding poses a serious danger in Britain: 1.4m people and £237 billion of property are at risk, according to official estimates. Clean-up costs after floods are high and rising. The Association of British Insurers (ABI) reckons that weather has cost the insurance business £6 billion in the five years since 1998, double the amount in the previous period; it expects the trend to continue. Public spending on flood defences currently stands at around £500m a year, but a recent report predicted that this could rise to £1.1 billion over the next 20 years. It blamed both climate change and increasing urbanisation.

There is no straightforward answer. Building flood defences often just shifts the water elsewhere. Roads may channel rain straight into rivers, making things worse, or they may serve as useful emergency conduits when normal drainage is overwhelmed. Perversely, defences can increase the potential consequences of a flood. Sebastian Catovsky of the ABI says that it is unclear how strict planning rules will be for well-protected but low-lying areas like the Thames Gateway, a huge planned development in east London. The Environment Agency may object to new building on flood-risk grounds, but lacks the power to enforce those objections. Flood barriers are designed to stop only a certain severity of flood, so if a big one breaches the defences of a heavily built area, the costs could be very high.

The government knows all this, and its consultation documents are full of appropriate buzzwords; the talk is of “integrated policies”, “stakeholder consultations” and “holistic approaches”. But the challenges are formidable. Officials want to focus on entire river basins when making policy, rather than individual towns or cities. This is sensible, but geography does not follow political boundaries, and some basins cover several local government areas. Getting them to work together is fiddly and time-consuming. It is not clear who is responsible for floods—is it the Environment Agency or the local council? And what about the water companies (who maintain the drains)?

Then there is the question of who should pay for the new schemes. Heavy rain earlier in the month overwhelmed London's drains and led to the discharge of 1m tonnes of raw sewage into the Thames. Thames Water wants to spend up to £3 billion on a giant overflow sewer to cope with such events in the future. That plan awaits ministerial approval. But a different arm of the state—the water regulator—has imposed limits on price rises, so it is hard to see where the money would come from.

Malcolm Dowden, an environmental law specialist, points out another problem: government-sponsored flood defences in one area may shift floods downstream to other areas. A recent court case means that the newly flooded homeowners could sue neither the developers nor the government for the increased risk they would bear. “They might be identified as uninsurable,” he says. Mr Dowden wants the state to step in as an insurer of last resort in cases where its own policies are responsible for putting people at risk of inundation.

All of these problems will have to be ironed out before the government publishes its final proposals. Officials like to talk about “joined-up government”. Flood defences will be an excellent test of what this might actually mean in practice.

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Exams

A pretty pass

Aug 26th 2004
From The Economist print edition

Test results are improving. But too slowly

AFTER four years of no progress, literacy and numeracy among 11-year-olds have started improving again. Not by very much, and the significance is dubious. But at least the government can claim things are moving in the right direction.

The number of children reaching the right level in English for their age rose from 75% to 77%. In maths, there was a one-point rise to 74%. That's not an impressive return on six years' study. Those that fail to learn the basics at primary school usually do badly for the rest of their school career. The government's target for both subjects, originally supposed to be met in 2002, is 85%. At current rates of progress, the new date of 2006 looks ambitious.

The value of the tests is much contested. When league tables of their results were first compiled in 1992, they highlighted the big variations between different schools—something that in the past parents had only guessed at. Now the stimulus is less: good schools know they do well, bad schools blame their “challenging” (education-speak for rowdy) intake.

The government thinks that concentrating advice and help on the weakest primary schools is working. Certainly poor parts of the country showed some of the best improvements. It now has to show that these are sustainable.

Another big piece of news this week was the results in the GCSE exams normally taken at 16, which were released on August 26th. These showed more pupils gaining the top grades, of A* and A, up from 16.7% in 2003 to 17.4% in 2004. Employers, a third of whom now have to give remedial maths and English teaching to the school-leavers they hire, increasingly discount anything less than a C grade at GCSE. Those gaining C or above rose from 58.1% last year to 59.2% this year.

The GCSE results dulled some of the shine of last week's statistics about the A-levels typically taken by 18-year-olds. One big issue in education is the poor performance of boys. Male candidates did rather better this year at A-level, which the government cheered. But this week's GCSE results showed little sign of the gap narrowing at that level. In other words, the one-third of brighter boys who go on to A-level are catching up the girls; the majority is lagging as badly as ever.

Another big issue is important but unpopular subjects. Science, for example, is plagued by a shortage of good teachers, particularly in state schools where pupils will be lucky to have a teacher with any academic qualification in physics or chemistry. Here the news is mixed. At GCSE entries for science subjects rose by an encouraging 5%. But the story at the more important A-level was different. Only 3.7% of A-level entrants took physics, for example, down from 4.1% last year. “Will physics be the new Latin?” asked one educationalist gloomily, referring to the collapse in past decades in that once unassailably important subject.

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Energy

The future's a gas

Aug 26th 2004
From The Economist print edition

Bloomberg News

Why worry about high oil prices, when a boom in natural gas may be on the way?

EVEN as headlines scream about $50 a barrel oil, energy firms and their investors are becoming increasingly excited about its likeliest replacement: not wind nor wave nor solar power, but gas—or, to be precise, gas that is frozen and transported as liquefied natural gas (LNG). This is expected to become as ubiquitous and crucial to the global economy as petroleum is today. Scenario planners at Royal Dutch/Shell think that gas may surpass oil as the world's most important energy source by 2025.

While oil became increasingly important during the past century, for much of that period natural gas was seen as its ugly stepsister: burnt off or “stranded” when discovered by accident, and rarely sought after. Demand for gas has taken off in recent years, thanks chiefly to its greenness—it burns far cleaner than oil or coal, making it ideal for new power plants from California to China. And burning gas is much less carbon-intensive than burning coal—making it helpfully less easy to blame for global warming.

Until recently, the development of a global gas market has been hindered by one inconvenient fact. Gas is, by definition, gaseous at room temperature; oil is a liquid that can easily be transported. Gas traditionally needed elaborate systems of pipelines to get it from the wellhead to the customer. That meant it was typically used fairly close to where it was produced, shipped at great expense via pipeline—or, more often, simply wasted.

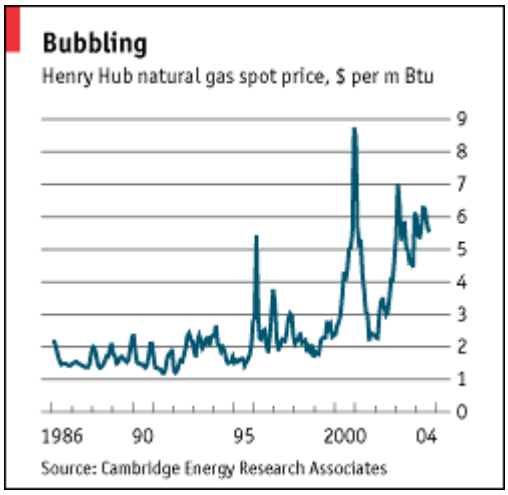
The rise of LNG promises to change that. Put simply, gas can be frozen into liquid form near its source, shipped to market in refrigerated tankers, warmed back into gaseous form on foreign shores and injected into the local pipeline system. Thanks to this technological advance, gas has the potential to be a fungible, global commodity like oil.

True, energy-poor countries such as Japan and South Korea have long relied on a rather clunky form of LNG. But soaring demand for gas has unleashed rapid innovation and investment that is driving down the capital cost of LNG. Tanker ships are getting bigger and more affordable. One-off project planning is giving way to economies of scale. Even so, shipping gas remains much more capital intensive than shipping oil. Building typical 5m tonne “trains” of LNG—which include liquefaction plants, tankers and regasification terminals—can cost $5 billion. Thus, as one senior gas executive puts it, “only a few firms can play in this game.” Still, leading executives now expect the energy industry to invest a massive $100 billion in expanding LNG over the next decade.

This expansion of LNG is being driven by America, the world's largest energy market. As demand for gas

has taken off in recent years, North American supply has not kept pace, causing a spike in prices (see chart) that, last year, alarmed even Alan Greenspan, chairman of the Federal Reserve, America's central bank.

America's market is clearly ripe for imported gas. On one estimate, North America's now puny gas imports could soar over the next decade or so to be as large as today's entire global LNG market.



Yet already energy pundits in America are ringing alarm bells about rising gas imports. In particular, they point to three long-standing worries about oil that they now think may be true of gas, too: scarcity, ever-rising prices and oligopoly power.

It has become fashionable to claim that the world is running out of oil and gas. Several alarmist books have just been released, ranging from “The End of Oil” to “Out of Gas”, claiming that the hydrocarbon age is drawing to a close. To the doomsday crowd, the spike in natural gas prices is permanent, the result of scarcity.

From OPEC to OGEC?

This is not the first natural gas “crisis.” In the 1970s, fears of global gas scarcity led many governments to ban the use of gas in electricity generation. Price controls at the wellhead in America held back the development of new supplies. Yet, in fact, there was never a genuine shortage of gas, merely a disincentive for firms to find it. When America deregulated its gas markets in the 1980s, unleashing the incentive to discover and market gas, prices collapsed—and stayed low for more than a decade.

This time prices have soared because—with the exception of Alaska, which is distant from most consumers—North America is indeed running out of gas. Yet the rest of the world is awash in gas. The reason that this was not recognised sooner, says Joseph Naylor, who runs Chevron Texaco's gas efforts, is because “firms simply never looked for gas before.” As energy liberalisation gathers pace, from Spain to South Korea, argues BP's Anne Quinn, “fungible markets will attract supply.”

If scarcity is not a serious worry, what of ever-rising prices? Certainly, there are plenty of experts who expect prices to remain high for many years, even if rising supply pricks today's gas bubble eventually. That is because, with LNG capacity taking years to build, supply will rise slowly. Sara Banaszak of PFC Energy, a consultancy, says that “LNG cannot prick the price bubble in the next 6-8 years.”

Still, it will be surprising if LNG imports do not ultimately lower American gas prices below $5 per mBtu from today's over $6. LNG is usually profitable at $3.50 (BG, a British firm, says it is profitable at $2.50), so there is plenty of incentive to invest in capacity at today's prices—as long as local planning rules and safety fears do not stop LNG terminals being built.

What of the third comparison with oil: the threat that a new cartel will be established, a gas version of OPEC? Around three-quarters of the world's proven gas reserves are in the former Soviet Union and the Middle East. Amy Jaffe of Rice University worries that rising LNG imports may give Russia, the kingpin of gas reserves, huge market power from around 2020. Maybe. But there are several reasons not to expect an OGEC gas cartel.

Around three-quarters of the world's proven gas reserves are in the former Soviet Union and the Middle East

What gives Saudi Arabia power over the oil markets is its massive investment in spare capacity, says David Victor of Stanford University. Indeed, the main reason oil prices are now surging beyond OPEC's control is that the Saudi buffer is precariously low. The capital expenditure needed to build spare LNG capacity is so much larger than that for oil that nobody with any sense will do this. Firms with control over local pipelines may well exercise some market power, argues Mr Victor, but a global gas cartel seems unlikely.

Moreover, gas reserves are in fact more widely dispersed and more abundant than oil reserves. That means that the potential troublemakers, from Iran to Russia, are not guaranteed to attract investment. Rather, Mr Victor and Ms Jaffe agree, western capital will probably flow to those countries with the most investor-friendly policies. That is why Trinidad is being developed as an LNG producer before its turbulent

neighbour, Venezuela, and why Qatar is emerging as the Middle-Eastern Goliath of LNG even as massive gas reserves in investor-unfriendly Iran and Saudi Arabia remain largely untapped.

Despite the current optimism, the huge political and financial risks inherent in the LNG business mean that the boom is not yet certain to happen. The capital required is huge, the number of firms with deep enough pockets very small, and the memory of the earlier gas-price collapse induced by America's deregulation is fresh. As Malcolm Brinded of Shell puts it, “our hopes have been dashed before.”

Yet, at today's prices, the potential rewards are fabulous for those firms with the courage, capital and competence needed to complete LNG projects. As Mr Brinded himself concludes, “gas will be the fuel of choice for at least the first half of this century (and) flexible, long-distance supplies of LNG are the key.” Get ready for a $100 billion investment boom, the prelude to the “century of natural gas”.

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Environmentally friendlier driving

Driven by the oil price

Aug 26th 2004 | DETROIT
From The Economist print edition

Rising demand for greener cars

OIL around $50 is good news to some. For Toyota, it is a wonderful boost for the Prius sedan, driven round Hollywood by stars wanting to show off their green credentials. Government ratings put the Prius's petrol consumption at an average of 60 miles per American gallon (mpg) in city driving—three times the mileage of, say, a sports-utility vehicle. Yet not everyone is persuaded. In June, tests by the influential *Consumer Reports* magazine yielded only 35 mpg in the city, "not nearly as high" as promised.

Battery-powered electric vehicles have less range than most motorists want. But the Prius is a "hybrid-electric vehicle", or HEV, which mates a conventional petrol engine with an electric motor. It operates on electric power only for several miles at a time, at relatively low speed. Its small battery pack is recharged whenever the vehicle coasts or brakes. In normal city driving, the two sources of power work together.

Demand for the Prius has shot up. In the seven months to the end of July, Toyota sold 27,013 of the vehicles in America, up 154% on the same period in 2003. There is a backlog of 22,000 orders, and in parts of the country an eight-month wait to take delivery. Early this month, Toyota announced plans to boost production by 50%.

Until recently, Honda was the only other maker of hybrids. Now America's three carmakers are racing to catch up. Ford is launching its Escape Hybrid, the world's first HEV sports-utility vehicle. DaimlerChrysler and General Motors are rolling out hybrid pick-up trucks. Even Bob Lutz, a famous petrol-head and GM's second-in-command, believes that gasoline-electric technology could soon account for up to 7% of America's annual 17m vehicle sales. "People don't buy hybrids for fuel economy," says Mr Lutz. "They buy one to make an environmental statement."

It remains to be seen if hybrids are a passing whim, and how long their complex transmissions last. They may soon face a strong challenge from another high-mileage option: diesels. Popular in Europe, diesels had all but vanished from American roads until recently. Today's diesels are a far cry from the noisy, smelly, poorly built cars of the 1980s, and Volkswagen and Daimler both have new models coming. But greens may slow their arrival by demanding laws mandating new low-sulphur diesel and cleaner emissions. Until then, hybrids will have the green market to themselves—even if the actresses tire of them.

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Retailing

Turning Japanese

Aug 26th 2004 | TOKYO
From The Economist print edition

Is Japan a big opportunity for Wal-Mart, Tesco and other foreign retailers?

AFP

Wal-Mart tomorrow?

IT IS hard to imagine a more contrasting pair of retailers than Japan's Daiei and America's Wal-Mart. The only benchmarks consistently lower than Wal-Mart's competitive prices are the performance standards to which Daiei's managers hold themselves. Although Japan's third-biggest retailer has been bailed out twice in the past three years, receiving total loan write-offs of ¥640 billion ($5.1 billion), it shows little sign of restoring itself to solvency, let alone profitability. Daiei's managers admit that they need help yet again, but continued to cling this week to a feeble plan that would involve lots of vanishing debt but little genuine restructuring. Daiei's bankers instead want sweeping changes that would fix its problems for good. That has prompted Wal-Mart, among others, to consider buying Daiei's retail business, as part of any overhaul.

Japan's biggest supermarket operator, Aeon, has also said it is interested, and Ito-Yokado, the second biggest, is said to be considering a bid too. Several private equity funds are also looking for ways to get a stake in Daiei, perhaps by joining forces with one of the interested retailers. They include Ripplewood—an American fund that last year arranged Japan's biggest-ever leveraged buyout, of Japan Telecom's fixed-line business—and Kiacon, a domestic fund specialising in reviving retailers.

Aeon is keen to grow and announced earlier this year that it would raise ¥100 billion in the stockmarket to finance new stores. Acquiring Daiei—as it did another failed retailer, Mycal, which went bust in 2001—would be one way to grow quickly. Moreover, Aeon will be keen to stop Daiei's retail network going to Wal-Mart or another foreign competitor. Since Japan's restrictive zoning rules were relaxed in the late-1990s, Wal-Mart and other big foreign retailers have established a toehold. Aeon's boss, Motoya Okada, says that his biggest challenge now is to win the race “between how much time we will need to become competitive, and how much time global retailers will need to understand Japanese consumers and the market.”

Carrefour, a French supermarket operator, has opened eight outlets in Japan, including four in the past year. Tesco, Britain's biggest supermarket operator, has acquired a pair of smallish Japanese retailers, C Two-Network and Fre'c, and is quietly looking to expand further. Wal-Mart has so far taken a cautious approach in Japan. In 2002 it bought a small stake in Seiyu, a big department-store chain, which it has since increased to 37%. Seiyu's managers have fiercely resisted Wal-Mart's no-nonsense, cost-cutting approach, but that is unsurprising, and it is too soon to rule this venture a failure. Nor is it clear yet whether Wal-Mart is keen on Daiei because it has been disappointed with Seiyu or because it actually likes what it has learned so far about Japan.

But Daiei's managers seem determined to disappoint Wal-Mart and many other suitors. They have stitched together a plan that would call for more debt write-offs and closer co-operation with Marubeni Corporation (a trading company with which it does a lot of business) and Tokyu Land (which Daiei believes can help it manage its hotels and other property holdings). The plan is a desperate effort to avoid being sent to Japan's Industrial Revitalisation Corporation, which was set up last year to take bad borrowers away from the banks and reshape them into something (hopefully) more sensible. This state-run outfit would be charged with deciding how to split up Daiei's business units, and to whom they should then be sold.

Clearly, Daiei's managers—who still defend the firm's ownership of a baseball team, along with many other non-core businesses—do not grasp the concept of “three-strikes-and-you're-out”. But unfortunately for them, the firm's biggest lender, UFJ, is under fierce pressure from regulators to raise its own game by cleaning up bad loans properly, rather than finding temporary fixes (see article). If the bankers stick to their new hard line, the battle to buy Daiei will soon be heating up.

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International water companies

The flood dries up

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Life is not easy for the three-biggest private-sector water firms

IT SOUNDS a great business to be in: a product with no known or even imaginable substitute, ever-growing demand, tied customers. But in fact the three biggest private-sector water companies in the world are eager to get out of stretches of it. The same reasons that give water (and the related sewerage business) its appeal make it both highly regulated and vigorously political. In many poorer countries, the political and regulatory risks are now so great that the biggest water firms are washing their hands of any involvement. RWE Thames Water has just pulled out of a sewerage plant in Shanghai. That was not the first such retreat, nor will it be the last.

Two of the three biggest firms are French: Suez, owner of the former Lyonnaise des Eaux; and Veolia Environnement, spun out of Vivendi in 2002 and, by origin, Générale des Eaux. These two have dominated water supply in France since the 19th century, and were naturals to spread abroad as the wider world—not least the World Bank—embraced private-sector water in the past 20 years. Thames Water, which handles London's water and sewerage, is a relative newcomer. It was privatised in 1989 by Margaret Thatcher, and then bought, as a plunge into the global water business, by RWE, a German energy-centred conglomerate, in 2001.

All three firms have met hard going in the third world, and are pulling back. Thames had run its Shanghai plant for four years before China's government ruled in 2002 that the agreed rate of return was illegally high. Haggling led only to deadlock and, this July, to Thames's withdrawal. It has had worse trouble than that in Indonesia. It leapt into Jakarta's water privatisation in 1997, and has steadily lost money there: consumer resistance and political unease held up rate rises, which in turn, allied to allegations of poor performance, brought bad press and, this summer, a court case. Thames, openly, is now reviewing its operations outside Europe and North America, and is already talking to potential purchasers, it says.

Suez too has decided, again openly, to cut its commitment and its risks in poor countries. Besides Jakarta—it too is in a joint venture there—in the 1990s it went into three contracts in Argentina, notably in Buenos Aires. It was happy enough until the Argentine peso, which had long been tied to the dollar, collapsed in 2002. Suez's debt was mainly in dollars, but its charges to consumers were in pesos, and it was denied permission to raise them accordingly. That argument continues.

So does one in the Philippines, where Suez's joint venture, Maynilad Water, to supply part of Manila, went sour. A state-promised reservoir scheme was never in fact built, the El Niño weather phenomenon in 1997-98 cut rainfall, and two-thirds of the water brought no revenue anyway. On top of that, Maynilad, laden with 90% of the old state supplier's debt, saw the Filipino peso slump. Early last year it said it would quit, and later filed for protection from its creditors. To add to Suez's woes, a new government plan to take over 60% of Maynilad now faces a legal challenge.

Veolia has not had such high-profile trouble in poor countries. Indeed last December it added a contract in China to seven already there; the Chinese government, for all its Shanghai dispute with Thames, knows it has huge water-supply and sewerage problems, and is eager for outside help in handling them. And China's currency is, if anything, likely to rise. But in the 1990s, Veolia lost an Argentine contract, and in 2002 a huge one in Puerto Rico (which went instead to Suez's water arm, Ondeo—and was in turn cancelled last January). Veolia too is now cautious of third-world risks.

But there is more to the story than this. Puerto Rico may be poor, but it is, after all, part of the United States. The water barons' trouble has sprung not just, or even mainly, from the poor countries' consumers, officials or currency risks, but from their own fast growth, and resultant debt, in rich ones. And that, indeed, is where the biggest recent retreats have been.

Vivendi rushed to pay over $6 billion for a big American company, US Filter, in 1999. Veolia has just got rid of most of it—notably, to Siemens, this spring—at an overall loss, the new management admits, of $4 billion. It is about to sell Culligan, another bit of US Filter, for $610m. As for Suez, its worst press has come in America: first from the cancellation of a contract in Atlanta, and then the Puerto Rican one, which in 2002 it had hailed as “the world's largest”. And its biggest retreat has been the $4.3 billion sale of Nalco, Ondeo's Illinois-based water-treatment arm.

RWE too expanded heroically: it paid $6.4 billion in 2001 for Thames Water; $4.4 billion in 2002 for Innogy, a British power company itself laden with more than $3 billion of debt; and then $4.6 billion for American Water (plus its $3 billion of debt) in 2003. The result, by end-March 2003, was net debt of $24.5 billion. RWE has not retreated from these big first-world commitments, nor need it do so: its latest accounts, out this month, showed debt down to $19.5 billion. But at its Essen headquarters, that figure may well have brought some private sighs of relief.

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Business books

Torturing your rivals

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A new American business book causes a stir, even before its publication

HOW hard do American businessmen compete? The answer from Europe, which tends to view American business practices with horror and disdain, might be too hard. But a forthcoming book by George Stalk, a senior partner at the Boston Consulting Group (BCG), and Rob Lachenauer, boss of GEO2, a car-engine technology firm, makes the opposite claim. American business schools and executives now pay far too much attention to “soft” management issues, such as leadership, corporate culture, customer care and employee management. Popular business books urge managers to hug their customers or find the “leader within”. Nobody focuses on what really matters in business, they argue: the profits and pleasure that come from making competitors suffer.

Their book, “Hardball,” offers several strategies for the manager who suddenly realises that he is too squishy. Surprisingly, unleashing “massive and overwhelming force” against rivals is not top of the list. Thanks to America's bankruptcy courts, killing a competitor outright gives him a chance to return, cleansed of debt and unburdened of past mistakes. Far better, argue the authors, to weaken rivals to a point of near-death—and keep them there. This can be done in several fun ways: by systematically undercutting their most profitable products and services, luring them into lines of business that will make them less profitable, stealing their ideas and—well, you get the picture.

Although not due out until October, “Hardball” is already causing a stir. A recent article in the *Harvard Business Review*, in which Messrs Stalk and Lachenauer aired their ideas, got an icy reception in some quarters. In their original draft, they had urged businessmen to focus not just on creating “competitive advantage” but also “unfair advantage”. That phrase was replaced with the decidedly softer “decisive advantage”. With the editors at the Harvard Business School Press, the internal police at BCG also balked at some of the language, chuckles Mr Stalk. One chapter heading, urging managers to “Plagiarise, don't shade your eyes”, became “Take it and make it your own”. Another, “Drive up your competitors' costs,” became “Entice your competitor into retreat”. (An earlier version was the thoroughly wimpish “Entice your competitor into doing something different”.) Some of BCG's European partners, meanwhile, have reacted coolly to the book, pointing out that talk of gleefully stomping on one's rivals is far too rude for Europe's cultured boardrooms.

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Television

Move over, CNN

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Al-Jazeera will soon be available in English

FOR those who regard the al-Jazeera TV channel as a biased, anti-western mouthpiece for Osama bin Laden, the announcement that it will start broadcasting 24 hours a day in English next year will be unwelcome. Its likeliest audience is Muslims outside the Middle East who do not speak Arabic. Will al-Jazeera's reports of suffering and rage in Iraq and beyond inspire anger against America and its allies at home, too?

The new service may prove a bit less controversial than its Arabic sibling. Nigel Parsons, its managing editor, says that al-Jazeera has been too strident on occasions in the past, and that the English channel will seek to redress that. It will strive for balance, credibility and authority, he says, and it will signal a new maturity for al-Jazeera, which was started by the emir of Qatar in 1996.

It will broadcast its own original content—news, documentaries and talk shows—from studios in Doha, London and Washington, covering international news beyond the Middle East, especially the developing countries often neglected by existing English-language channels.

Al-Jazeera is already enjoying a fresh burst of attention outside the Middle East. Around the same time that the interim government in Iraq ordered it to shut its bureau in Baghdad, westerners started watching “Control Room,” a film sympathetic to the station directed by Jehane Noujaim. At a screening in London last week an audience of local journalists laughed along with al-Jazeera's reporters and editors at the expense of the American military.

The biggest mystery about al-Jazeera surrounds its funding, which “Control Room” sadly did not examine. Qatar has a new prominence in the world thanks to the station. That may be why the emir is willing to spend on an English-language channel even though the original Arabic one is probably losing money.

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Telecoms in China

Disconnected

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Life is getting harder for China's phone companies

AP

From little red book to Little Smart phone

WHEN it came to telecoms, a decade ago the Chinese barely whispered. China's fixed network was shabby. Mobile phones, internet and e-mail were non-existent. Today, in every city, the young and old are not only shouting into their phones, they are using them to send text messages, play games and photo their friends. At the end of June, China had 305m cellular subscribers and 295m fixed-line users, making it the largest market in the world for both and the fastest growing anywhere. Almost 70% of Chinese who can afford a mobile phone have one. “No other developing country has created such penetration in so short a time. There is ridiculous connectivity in China,” says Rohit Sobti, an analyst at Citigroup.

China Mobile and China Unicom, the two wireless operators, and China Telecom and China Netcom, the two fixed-line giants, have enjoyed double-digit growth in revenues and enviable levels of profitability. China Mobile made pre-tax profits of $6.3 billion in 2003. Its profit margins, like China Telecom's, exceed 50%—impressive by international standards.

This growth is widely expected to continue. Citigroup forecasts compound annual growth of 16% in wireless revenues until 2007 and 8% in fixed-line as household incomes rise and tariffs drop. While the state has retained ultimate control, such bullish forecasts have helped it to successfully list the first three groups on international stock markets. China Mobile currently is valued at $55 billion. Netcom has filed with Hong Kong and American regulators for a listing expected in October.

In telecoms, unlike most other sectors, China's industrial policy has been successful—so far. Realising that modern, affordable communications were vital to economic growth, the government, under Wu Jichuan, an enlightened head of the Ministry of Information Industries (MII), threw open the doors to foreign capital and technology, welcoming network and handset suppliers such as Nokia, Motorola and Siemens, while also nurturing domestic suppliers such as Huawei and Ningbo Bird.

Starting in 1995, Beijing introduced competition by breaking up the monopoly that was China Telecom—or, rather, it managed competition. In fixed-line, China Telecom was given 21 prosperous southern provinces, while Netcom got ten poorer northern ones—plus Beijing and a broadband network, as compensation. China Mobile and Unicom compete nationally, but the government has licensed only two operators, believing that the cut-throat competition of markets such as Hong Kong's impedes network development. “Chinese telecoms is a case study of getting regulation right,” says Citi's Mr Sobti. “China is leaps and bounds ahead of India.” His bank is helping to float Netcom and, unsurprisingly, is upbeat. But he has a point. India, with a population of 1 billion, not far off China's 1.3 billion, has fewer than 40m wireless subscribers.

Underneath this rosy picture, however, China's management of the telecoms sector is unravelling. Since the retirement of Mr Wu in March 2003, the MII has become weaker, less able to manage the state's conflicting agendas as regulator (it wants a cheap phone in every home) and as shareholder. As the telecoms firms have cut prices and increased capital spending to win new customers, SASAC, a holding company for the state's shareholdings, is worrying about their future profitability. The firms' government-

appointed managers grumble about state meddling that forces them to invest in a shoddy home-grown third generation (3G) mobile standard. Some even want the national players to remerge. Duncan Clark, head of BDA, a telecoms consultancy, says that the sector is in “absolute confusion. I have never seen this level of uncertainty before.”

The chaos is most evident in PHS—a “personal handyphone system” developed in Japan, which lets fixed-line providers broadcast to what are effectively powerful cordless phones. Locally called *Xiaolingtong* (“Little Smart”), PHS is spreading fast. From nothing in 1999, it now has over 50m subscribers, attracted by vastly lower monthly fees and broader bandwidth, despite its limited ability to roam. In some areas, 80% of new subscriptions are for PHS.

The irony is that, technically, PHS is still illegal in China. Mr Wu correctly identified it as a threat to the cellular operators and forbade it. Now, China Telecom and Netcom are openly promoting it. MII is unsure whether to welcome a new service or stamp on a threat to half the industry.

Little Smart is stealing subscribers and hurting the profitability of the mobile companies. China Mobile's average revenue per user has started to fall. Unicom has been hit harder, compounded by another piece of government meddling which forced it in 1999 to adopt America's CDMA technology as well as the existing GSM European standard. The rise of Little Smart has forced both wireless firms into deep discounting and promotions—despite orders from MII that price wars must stop.

An even bigger threat to profits looms: 3G. Mr Wu originally promised to award a 3G licence to each of the four big operators. But given the lukewarm reception to 3G worldwide and the potentially ruinous cost—China Mobile, with the most extensive 2G network, thinks that the upgrade would cost it 60 billion yuan ($7 billion)—those plans have been scaled back. Yet Beijing may still award licences to China Mobile and Unicom, force China Telecom to roll out a home-grown TD-SCDMA standard and allow in one foreign operator.

Sorry, wrong number

Competition at this level could be disastrous for firms that are already investing heavily. This year China Telecom and Netcom will invest over 40% of revenues and Unicom 76%. Even firms in other developing markets rarely spend more than 15%. Hence a recently floated plan to turn the big four back into two by merging their still-unquoted state-controlled holding companies—China Mobile absorbing Netcom, China Telecom swallowing Unicom. That would cut 3G development costs. But it would enrage management and minority shareholders. It would reduce future competition markedly. And it could delay Netcom's initial public offering, just as it is trying to pull off a complicated deal to take a stake in the fixed-line business of PCCW, Hong Kong's main telecoms provider. Even if it proves to be a pipe-dream, such a merger proposal highlights how messy Chinese telecoms could become.

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Face value

Regaining energy

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Mayo Shattuck is leading the revival of America's energy trading business

HAVING spent the 1990s reinventing themselves as whizzy energy traders, America's power utilities have been just as busy recently convincing the world they want nothing to do with the suddenly-sinful business. Yet even as former trading giants such as Dynegy, American Electric Power and Reliant make humble journeys back to their basics as slow-growing, regulated utilities, a few courageous souls have dared to persevere with trading. One is Constellation Energy, the modern incarnation of Baltimore Gas & Electric, the descendant of America's first gas utility. Led by Mayo Shattuck, Constellation has, almost unnoticed, grown to become the biggest power trader in America.

At the height of new-economy lunacy, shareholders were bestowing on America's youthful energy-trading industry the sort of gravity-defying valuations typical for stars of the bubble. Fast money rushed into the industry, fuelling unbridled expansion, a power-plant building boom and all sorts of behaviour that Americans now understand to be “excessive”.

Going for gold

It was Mr Shattuck's luck to join the industry just as its fortunes went into a shuddering reverse. Following a high-flying career as an investment banker, which he crowned with the lucrative sale of his own firm, Alex Brown, to Deutsche Bank, Mr Shattuck almost took up an offer to head the US Olympic Committee. But a hankering for more work in the private sector and the prospect of dealing with the Olympic Committee's 120-strong board of squabbling directors persuaded Mr Shattuck to join Constellation instead, in October 2001. In the end, dealing with the Olympic Committee's tortuous politics might have been the more comfortable job. Within weeks of starting his new career, Enron's sudden collapse rocked the entire industry.

As a banker, Mr Shattuck had suspected before he joined Constellation that the energy-trading industry was in for a tougher time. Constellation's own energy-trading business had its roots in a 1997 joint-venture between Baltimore Gas & Electric and Goldman Sachs, an investment bank. Mr Shattuck planned to buy Goldman out, restructure the business, improve its risk management, trim the risks that its traders had been taking with shareholders' money, and hunker down.

But by the summer of 2002, the industry had gone from bad to awful. Some energy traders were mired in allegations that they had caused California's energy crisis in the winter of 2000 by rigging the markets. Congressional investigations abounded. “We didn't know how bad it was going to get,” says Mr Shattuck. “We had to test our resolve.” Along with Enron, all the big energy traders had “capitulated”, says Mr Shattuck. As regulators, bad publicity and fleeing investors overwhelmed the industry, Wall Street firms such as UBS (which bought Enron's trading operations) and Morgan Stanley quietly cleaned up.

As Mr Shattuck scrambled to refinance and reduce the firm's billions of dollars in debt and sell $1 billion-worth of assets, he resolved to stick doggedly to Constellation's trading strategy: there would be “no retreat”. With the firm's erstwhile bigger rivals fleeing the industry, Mr Shattuck figured there might be more business for him. In the 20-odd states which had deregulated their wholesale energy markets, freeing big customers to buy power from whomever they liked, Constellation's business customers would

still need the risk-management services that its trading arm could sell them: a guarantee to procure energy at a long-term fixed price from a market in which price swings in the hundreds of per cent are not uncommon. The main challenge was to persuade bondholders and banks not to pull the plug on him. A gamble? “Absolutely,” laughs Mr Shattuck.

Despite his efforts to shrink Constellation's debts, reduce its trading risks and embrace conservative accounting policies ahead of rule changes mandated by America's accounting regulators at the beginning of 2003, not everyone is yet convinced by his strategy. To Constellation's disgust, the latest comment on the firm's efforts by Standard & Poor's, an influential ratings agency, was to downgrade Constellation's credit rating in March, from A- to BBB+.

Mr Shattuck is unruffled. The rating agencies will come around in the end, he says. In the meantime, some of those Wall Street hopefuls that were poaching business in 2002 have since run into trouble. Fewer than 100 of the 630 traders that UBS bought from Enron remain with the firm. Morgan Stanley has had mixed results as well. Constellation's trading business, meanwhile, has flourished, and now accounts for about two-thirds of the firm's $9.7 billion of annual sales, a similar slice of its $470m annual profits, and almost all of its growth. Mr Shattuck predicts that his trading business will grow by 10-20% a year for several years to come.

Meanwhile, the stockmarket has begun to reward Mr Shattuck's dogged pursuit of trading, and Constellation is beginning to build a small and enthusiastic following: the firm's share price has almost doubled recently. As Mr Shattuck points out, despite the scandals, civil litigation and criminal prosecutions that continue to hang over energy trading, the thrust of state energy policies is still for the most part towards greater deregulation. As more big customers are freed to buy their power from merchant-energy firms, more of them will demand the sort of risk management that Constellation sells. In the long run, Wall Street's traders may find they lack the physical assets that make energy trading work. Only energy firms, he argues, can put together both the physical markets for production and transportation and financial markets for energy derivatives—and so arbitrage both efficiently. Whatever their other failings, Enron and the rest may have been on to something after all—though please don't call Constellation the new Enron.

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Motor racing

Chicanery in Formula One?

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Getty Images

Legal and commercial disputes are threatening the future of grand-prix racing

Get article background

THE 2004 Formula One (F1) season has not exactly set pulses racing: with five races to go, Michael Schumacher, a driver for Ferrari, looks certain to win an unprecedented fifth consecutive championship. Behind the scenes, however, there has been a much more exciting battle over who runs and controls the sport. Barring a last-minute settlement, the dispute will become public in a British courtroom in mid-September.

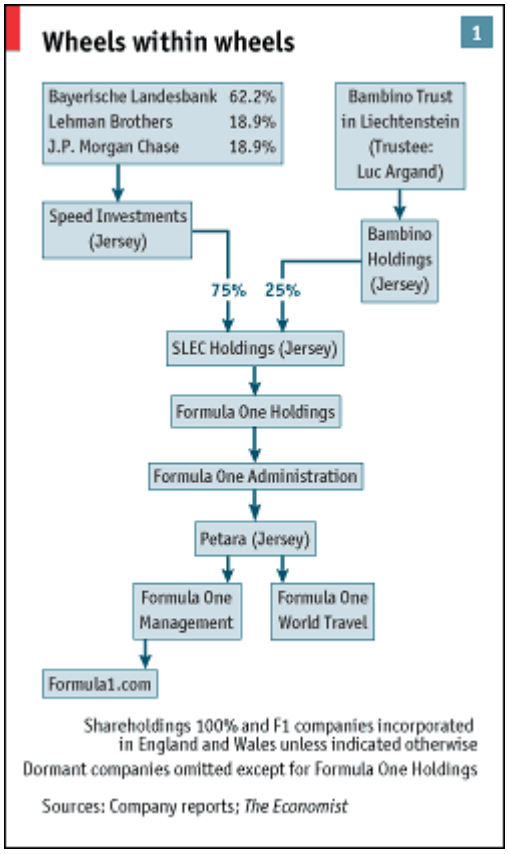
Bringing the case are three large banks—Bayerische Landesbank, Lehman Brothers and J.P. Morgan Chase. Through Speed Investments, these have a 75% shareholding in SLEC Holdings, which in turn owns the cascade of companies that run F1 (see table 1).

Incredibly, despite this majority shareholding, the banks do not have board control in any of the companies below SLEC. These include Formula One Holdings (FOH), an important, though dormant, holding company, and two crucial operating companies, Formula One Administration (FOA) and Formula One Management (FOM), which hold the commercial rights to F1 and through which hundreds of millions of dollars flow each year.

The nub of the banks' case is that the previous owner of their shares in SLEC did have board control. Yet they do not, and this puts them in a strange position—in effect they are minority shareholders. This makes their shares unsaleable at any reasonable price. This matters to more than just the banks: control of the Formula One companies' boards is essential at a time when the future of F1 is up in the air—contracts that govern it run only until the end of 2007.

So who does control the Formula One empire? Bernie Ecclestone, a British entrepreneur, the chief executive of FOA and FOM, and the

dominant figure on F1's commercial side since the mid-1970s, used to own FOM. But in 1996, as the first step in a complex tax-avoidance scheme, Mr Ecclestone transferred ownership to Petara, an offshore company controlled by Slavica Ecclestone, his wife.



Complicated shuffles in the British Virgin Islands and Jersey followed. By 1998, Bambino Trust, whose beneficiaries are members of Mr Ecclestone's family, owned the SLEC group through Bambino Holdings (Bambino). Bambino now owns 25% of SLEC, having raised $3.4 billion from a bond issue and by selling 75% of its stake in 1999-2001.

A “special adviser” to Bambino Trust and Bambino is Stephen Mullens, a lawyer who was a partner until 1999 in Marriott Harrison, a British law firm that has acted for FOA and FOM. He is an appointee of both Mrs Ecclestone and Bambino: Mrs Ecclestone appointed him to the board of Petara in 1995; and Bambino to FOH's in 1998 and to SLEC's in 1999.

In their case, the banks claim that Bambino has improperly and illegitimately wrested control of FOH (and hence FOA and FOM) through opportunistic and questionable legal manoeuvres, at the centre of which stood Mr Mullens. (He is not a defendant in the banks' action.)

Two of Bambino's directors are Luc Argand and his wife, Emmanuèle Argand-Rey, both Swiss lawyers. Mr Argand is also a trustee of Bambino Trust. Bambino and Mr and Mrs Argand, who are all defendants in the case brought by the banks, deny the bank's claims. To gain control of FOH, the banks are contesting the validity of Bambino's appointment in October 2002 of the Argands as directors of FOH, which gave Bambino control. If successful, the banks will have to launch further legal actions to win control of FOA and FOM. Only then could they wield powers commensurate with their holding in SLEC.

A shareholders' agreement (the “SLEC agreement”), signed in May 2000, sets out the composition of the boards of the F1 companies. It was drawn up when EM.TV &Merchandising, a high-flying German media company, bought Speed Investments, which owned 50% of SLEC at the time, from two private equity firms. EM.TV also acquired an option to buy a further 25% of SLEC from Bambino for $987.5m.

The SLEC agreement included various rights for Speed and Bambino to appoint directors to SLEC, FOH, FOA and FOM. These rights were written into the relevant articles of association, the legal document that governs the way a company is run.

With more than 25% of SLEC, Speed was entitled to appoint four “A” directors to each of SLEC and FOH; Bambino was similarly entitled to appoint four “B” directors. With not less than 5% but no more than 25% of SLEC, Bambino would be entitled to appoint two B directors to each company. And each of SLEC and FOH was to have a maximum of eight directors. So with 75% of SLEC, Speed could appoint two “ordinary” directors to each company as well as its four A directors.

One of Speed's four A directors on FOH's board had to be from WestLB, a German bank, which in 1999 had rescued a $1.4 billion bond issue for F1, the proceeds of which went to Bambino.

By the end of 2000, EM.TV was engulfed in accounting problems; its shares nose-dived. Kirch, at the time a giant German media group with pay-TV interests, spotted a backdoor way of acquiring control of SLEC. The SLEC agreement required EM.TV to get Bambino's permission if a broadcaster acquired control of Speed. To circumvent this provision, a complicated deal was structured. Its essence was that Kirch funded Speed's purchase of another 25% of SLEC, and Kirch acquired control of Speed from EM.TV via an intermediary.

Twists and turns

The total cost to Kirch was almost $1.6 billion, which it borrowed from the banks; extraordinarily, Bayerische Landesbank, which is half-owned by the state of Bavaria, lent the $987.5m for the option

payment. The banks took security on Speed's 75% interest in SLEC.

After the option was exercised in March 2001, Speed (ie, Kirch and EM.TV), as envisaged in the SLEC agreement, controlled SLEC's board, and SLEC the board of FOH. The mechanism by which FOH controlled FOA's board was to become significant.

By now, Speed was entitled under FOA's articles to appoint one A director to FOA, and Bambino one B director. But, under the articles, FOA's shareholder (ie, FOH, which Speed controlled) was able to set the firm's maximum number of directors. A resolution by FOA in June 2001 limited the number of its directors to three. So FOH could appoint one ordinary director to FOA's board, which Speed did. Thus, from June 2001, FOA's board comprised two Speed representatives and Mr Ecclestone, who was a Bambino appointee but was not formally designated a B director.

A similar mechanism existed for control of FOM. However, apparently out of deference to the wishes of Mr Ecclestone, FOA did not take control of the board of FOM's immediate holding company, Petara, which remained in the hands of Mr Mullens and Mrs Ecclestone. And whoever controlled Petara had the ability to control FOM. Nevertheless, from June 2001, FOM'S board had the same composition as FOA's.

Before long, the Kirch group collapsed under the weight of its massive debts; the part that controlled Speed filed for bankruptcy in June 2002. The banks then enforced their security over Kirch's shareholding in Speed so that they would become entitled to exercise Speed's rights. But clearance did not come from the European Commission until late September. During this interregnum, Bambino began its grab for control of FOH, FOA and FOM. Bambino denies this: its defence is that its actions were in F1's long-term interests.

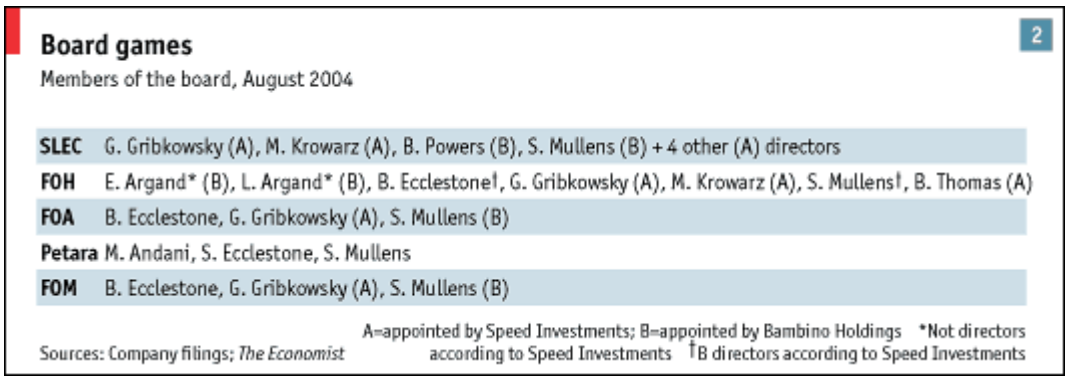
In mid-September 2002, Bambino appointed Mr Mullens as its B director of FOA, taking the number of FOA's directors to four, and simultaneously removed Speed's ordinary director on the grounds that the maximum number of three had been exceeded. As it had appointed two of the three directors, Bambino had control.

One of the four A directors on FOH's board thought that Bambino was hijacking FOA's board and resigned in protest. A week later, Bambino appointed Mr and Mrs Argand as B directors of FOH. As Mr Ecclestone and Mr Mullens were already on FOH's board, Bambino now had four directors and de facto control. But with its 25% shareholding, Bambino was entitled to appoint only two B directors to FOH, and had—Mr Ecclestone and Mr Mullens.

Another A director resigned from FOH in mid-October, which meant that there were now only two A directors on the board. FOH rejected the banks' attempts to fill the vacancies for A directors before a FOH board meeting in late October.

At this meeting, the FOH board voted, by a majority of five, which included WestLB's appointee, to one, to amend FOA's articles. The change, which Mr Mullens suggested, was small but extremely significant. Instead of being determined by a shareholder resolution (and hence within FOH's control), FOA's maximum number of directors was simply to be three. As the change to FOA's articles cannot be reversed without Bambino's consent (or alternatively a court challenge), the effect was to entrench Bambino's control of FOA, even if the banks were to regain control of FOH.

Bambino used similar manoeuvres in FOM, though the process was simpler because Mr Mullens and Mrs Ecclestone already controlled Petara's board. In July 2002, Bambino appointed Mr Mullens as its B director to FOM's board; in mid-September, Petara removed Speed's ordinary representative on FOM's board; and a month later Petara made the same small but significant change to FOM's articles. (Table 2 shows the current directors of each company.)



Board games 2

Members of the board, August 2004

SLEC	G. Gribkowsky (A), M. Krowarz (A), B. Powers (B), S. Mullens (B) + 4 other (A) directors
FOH	E. Argand* (B), L. Argand* (B), B. Ecclestone†, G. Gribkowsky (A), M. Krowarz (A), S. Mullens†, B. Thomas (A)
FOA	B. Ecclestone, G. Gribkowsky (A), S. Mullens (B)
Petara	M. Andani, S. Ecclestone, S. Mullens
FOM	B. Ecclestone, G. Gribkowsky (A), S. Mullens (B)

Sources: Company filings; *The Economist*

A=appointed by Speed Investments; B=appointed by Bambino Holdings *Not directors according to Speed Investments †B directors according to Speed Investments

Unbothered, Bernie?

“I am not involved in or concerned with [it],” Mr Ecclestone says of the banks' court action. As an alternative, the banks could have removed Mr Ecclestone as a director of FOH, FOA and FOM to gain control. Commercially, this would have been a brave step. But the banks might have then faced a lawsuit from Mr Ecclestone.

Indeed, Mr Ecclestone says he had nothing to do with either Bambino's appointment of Mr Mullens to the boards of FOA and FOM or with its appointments of the Argands to FOH's board. At a preliminary hearing in July, counsel for Bambino stressed the importance for Mr Ecclestone and Bambino Trust of the “separateness” between them “for various reasons”.

But Mr Ecclestone was not altogether uninvolved. After all, he was one of the five FOH directors to vote in favour of amending FOA's articles, which the banks claim was an improper change. Mr Ecclestone says he believed the vote by FOH's board “to be in the best interests of the company and its subsidiaries”. He adds that Bambino “does not have four appointees on FOH's board, nor does it control FOA or FOM”.

A schedule to the SLEC agreement, which Bambino warranted as “true, complete and accurate”, listed Mr Ecclestone and Mr Mullens as B directors of FOH. Mr Argand signed the SLEC agreement on behalf of Bambino; Mr Mullens on behalf of FOH. Yet as part of Bambino's defence to the banks' action, Mr Mullens claims that the designation of Mr Ecclestone and himself as B directors was a mistake because it did not reflect the intention of the parties to the SLEC agreement. Therefore, according to Mr Mullens, Bambino was entitled to appoint the Argands as its two B directors in October 2002. A partner in a British law firm, who negotiated the agreement with SLEC's lawyers on behalf of EM.TV, states that “he does not consider there is any basis for Mr Mullens's assertion”.

At the preliminary hearing, Mr and Mrs Argand challenged the jurisdiction of the British court on the grounds that there was a related prior claim in a Swiss court, which should be decided first. The banks had first served their writ on Bambino in Jersey then days later on Mr and Mrs Argand in Switzerland. In the interval, Bambino, of which the Argands are directors, named them as defendants in a court action in Geneva. This case, in which Bambino wants the Argands merely to declare that they were validly appointed as FOH directors, may not be decided until 2006. Rejecting the challenge, the British judge remarked wryly that the Argands were not “likely to fight very hotly” the Swiss action.

End of the road?

On December 4th 2003, the Hotel du Rhône in Geneva was bristling with bodyguards when senior executives from five large carmakers—BMW, DaimlerChrysler, Ferrari, Ford and Renault—which back half of Formula One's ten teams, met Mr Ecclestone (for FOA), Mr Mullens (for Bambino) and the banks. After a few hours, the parties shook hands on a deal for the sport's structure. Two weeks later, all the parties represented in Geneva had turned the handshake into signatures on a confidential memorandum of understanding (MOU), the main purpose of which was to end a three-year threat from GPWC (a company jointly owned by the five carmakers) to establish a rival motor racing championship in 2008.

GPWC's major concession was to shelve its plans, which first surfaced ostensibly out of a fear that Kirch's long-term goal was to transfer coverage of the sport from free-to-air to pay-TV. But GPWC and the teams have other substantial gripes, which the MOU sought to address. The Concorde agreement, a ten-year deal between the teams and FOM, governs how revenues are shared and how the sport is run. But

four carmakers have bought or set up teams since it was signed in 1998, and so did not participate in its negotiation.

The Economist estimates that F1's commercial rights yielded around $800m of revenues in 2003. Yet the teams receive a meagre share: only 47% of the TV money (in total some $375m in 2003) and none of the lucrative fees that grand-prix promoters pay—$20m in the case of newer circuits, such as Bahrain.

And there is a lack of transparency to Formula One's commercial deals. For most grands prix, income from trackside advertising, title sponsorship and upmarket corporate hospitality—all part of the estimated revenues of $800m—goes to Allsport, a Swiss company whose ownership is obscure. The MOU envisaged bringing Allsport into the SLEC group as soon as possible, and provided the teams with significantly more money, calculated on all the revenues from the commercial rights.

As the car companies involved spend hundreds of millions of dollars each year, they want a stable sport and a say in how it is run. A drastically revised Concorde agreement lasting until 2014 was to be drawn up, with clearer technical rules and a much reduced role for the sport's governing body, the Fédération Internationale de L'Automobile (FIA),which was not consulted over the MOU.

If a breakaway were to happen in 2008, SLEC's cashflow would soon dry up. Although SLEC owns the rights to the sport until 2110, the F1 brand would be virtually worthless without the current teams. This may explain why the banks and Bambino signed the MOU. Even though the banks were surrendering a chunk of the cashflow SLEC now enjoys—better something than the risk of nothing after 2007—they have their eye on an eventual flotation to recoup their investment. And GPWC signed because it had extracted major concessions and would avoid the expense, distraction and dislocation of a new series.

Also included in the MOU were seats for GPWC on SLEC's board and external managers for FOA and FOM to look over Mr Ecclestone's shoulder. But, according to GPWC, instead of implementing it by mid-2004 as promised, Bambino and Mr Ecclestone, perhaps unwilling to cede control as the MOU provided, began to stall.

Part of the MOU was leaked. The three most important teams—Ferrari, McLaren and Williams—were jointly to receive $150m under the MOU in settlement of secret side-letters that SLEC had given in 1998 as an inducement to sign the Concorde agreement. In the case of McLaren and Williams, these letters had promised a slice of FOH on its flotation or private sale. The flotation never happened and shares in SLEC, not FOH, were sold privately—a sore point. The effect of this leak and others was to turn the owners of smaller teams, who thought they had rumbled GPWC-backed teams trying to line their pockets, against their bigger rivals.

Forcing the pace

In April, GPWC lost patience, terminated the MOU with a terse announcement and swung into action behind the scenes with its plans for a rival series. Mr Ecclestone accused GPWC of “wasting his time”.

Before long, Max Mosley, president of the FIA and a friend of Mr Ecclestone, announced new engine specifications and proposals to downgrade the importance of cutting-edge technology. One effect of these measures, which Mr Mosley says are to promote F1 as a battle of skill, would be to reduce the influence of the carmakers.

All the teams agree that the costs of competing in Formula One are too high; budgets are ten times what they were a decade ago. However, the larger teams resent the FIA's attempt to impose a solution unilaterally. Unanimous agreement of the teams is needed to change engine specifications before 2008, but Mr Mosley is now trying to have his proposals, which he says are in F1's best long-term interests, adopted for next season on safety grounds.

Privately, many in Formula One would welcome a GPWC series. Few yet believe it will happen: car executives come and go and running a championship is not their métier. Could Ferrari, F1's most famous brand, act alone, challenging the other teams to follow? (Unsourced) press reports suggest Ferrari has concluded a deal with FOA for 2008 and beyond, but this is the sort of rumour to which GPWC is prone.

Mr Ecclestone, who is 73, is a great survivor. But if the banks win their legal battle, they might decide to remove him as F1's chief executive. And if the car companies do break away, then the sport would be

utterly reinvented after 2007. To safeguard it, the banks may have to act quickly. Ignore the one-man show on the track: the battle for Formula One has never been hotter.

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Deutsche Bank

A giant hedge fund

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Germany's biggest bank will soon be not much of a bank, unless it changes course

JOSEF ACKERMANN, the Swiss chief executive of Deutsche Bank, is back in charge, but for how long? His aides insist that the Mannesmann trial, in which charges against him and others for awarding excessive bonuses were dismissed in late July, did not distract Mr Ackermann from running the bank. Perhaps not; but in that time his credibility has been weakened by a number of setbacks.

Profits from investment banking, on which he and his closest officers stake their reputation, sagged in the last quarter. Aggressive trading by Deutsche, either for clients or its own account, has drawn the attention of regulators. Worst of all was the bank's widely criticised decision, two months ago, not to buy Postbank, Germany's biggest retail bank. Such a purchase would have sent a strong signal that Mr Ackermann cares about broadening Deutsche Bank's domestic base.

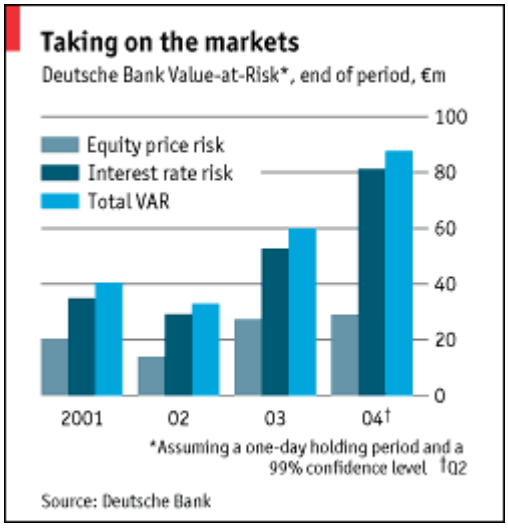
It would, however, have meant a *volte-face*. For Mr Ackermann and his ten-man group executive committee have taken Deutsche in precisely the opposite direction. Since 1996, they have been transforming it from a giant institution serving German commerce to a global money machine with no particular national loyalty. The bank has given up on its ambition to become a financial supermarket like the mighty Citigroup. Now it increasingly models itself on Goldman Sachs—which does not shirk from taking risk—to the detriment of its other existing and potential businesses. According to one joke circulating in Frankfurt, the German financial centre where the bank is based, Deutsche is actually run by an Indian “bond junkie”: Anshu Jain, its head of markets.

Mr Ackermann and Rolf Breuer, head of Deutsche Bank's supervisory board, would argue that the German bank had no choice. Its domestic market is fragmented and impossible to consolidate because of regional politics. Adventures abroad, and the reduction of lending until it became profitable were the only courses open to it. And they can point to the strategy's success: Deutsche managed a 21% return on equity in the past two quarters; only Commerzbank came close with 15.6%.

The bank's critics, and there are many, wonder why it burned its boats so unnecessarily. Other banks that were once in its position, or even weaker, such as Royal Bank of Scotland, HSBC, BNP Paribas, UBS or Credit Suisse, have not expanded their wholesale business at the expense of their domestic retail base; most, indeed, came to realise that a strong retail base was crucial.

The answer is that none of these banks was hijacked in quite the same way by its investment bankers. In 2000, Deutsche's investment bankers sabotaged what, in retrospect, would have been the best solution to consolidating German banks: a merger

with Dresdner Bank, a deal that had been signed but not delivered. It has shunned mergers with other banks because of potential job losses. But Germany's private banks, which together have only 28% of the country's banking assets, will never consolidate without a degree of blood-letting.



Observing the proprieties

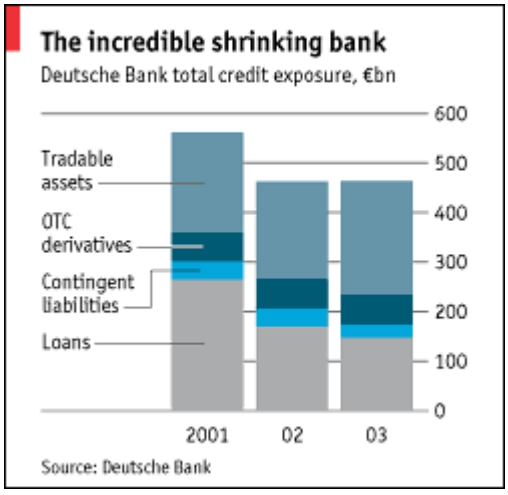
Mr Ackermann and his team have other priorities than messy domestic mergers. They want to create a global institution with a 25% return on equity. If that cannot be done by serving customers, domestic or otherwise, then it must be reached by trading for its own account—by becoming, in other words, a hedge fund.

Proprietary trading—punting with the bank's capital—has become an ever larger part of Deutsche Bank's business. Formerly, 80% of its trading positions were taken on behalf of customers, 20% for its own account. Now it admits to 30% for its own account, which probably means it is even higher. Even if it is not, the distinction between the two sorts of business is more apparent than real: risk, after all, is risk.

Its penchant for betting on markets shows up in the numbers it gives for value-at-risk (VAR)—the maximum it reckons that it could lose on a bad day. As a model, VAR depends crucially on volatility: the lower the volatility of financial markets, the greater the number of positions that a bank can have for a given amount of capital. As volatility has fallen sharply since the autumn of 2002, so positions have climbed. In addition, banks have devoted more money to trading. All in all, positions are many times what they were. Deutsche is an extreme example.

Richard Evans, Deutsche's head of market risk, says that the bank is very conservative about changes in volatility. Perhaps so, but it is still taking huge positions. In any case, VAR is flawed because it does not work when it is most needed: when markets fall apart. Like others, Deutsche therefore applies weekly “stress” tests to calculate how much “economic capital” it needs to buffer its risk positions under such conditions. But those tests are only as good as their designers' imaginations.

Still, better, perhaps, to take the positions in liquid instruments, which can be sold rapidly, than in illiquid loans or in private equity. Deutsche says that it reduced its positions in “alternative assets” (including private equity) from €9.7 billion ($10.2 billion) at the end of 2002, to €3.5 billion by this June.



Er, and hedge funds?

Unfortunately, that figure does not include investments in hedge funds. Like some of its biggest rivals, Deutsche is heavily involved as a financier—or prime broker—of hedge funds. That gives it useful information: banks often take the same positions as hedge funds. Moreover, as with other banks, Deutsche runs its own in-house hedge funds and provides seed money to talented traders to set up hedge funds outside the bank.

It is impossible for outsiders to determine how much of the bank's own money is invested in hedge funds. Deutsche has a hedge-fund division called DB Absolute Return Strategies, with over $9 billion of investors' money under management. It has also invested some of its own money—over $600m, it says—in the same funds.

There is another division, DB Advisors, which invests the bank's own capital in hedge funds. Just to confuse things further, DB Global Masters Fund allows outside investors to piggy-back on DB Advisors' trades. Twice this year teams of the latter's star in-house hedge-fund managers left to set up on their own. Far from freezing them out, DB Advisors invested capital in them.

The biggest problem with Deutsche's metamorphosis into a trading firm is that everybody else is doing

the same, and the number of strategies and talented traders is limited. Forecasters of the top investment banks' quarterly results need often look no further for an indicator than the monthly hedge-fund index returns. And these seem to be falling: hedge funds as a group have had a dismal time this year. So Deutsche Bank's reliance on such a strategy will not consistently, if ever, get it to 25% return on equity.

The temptation, therefore, has been to do it by other means, sometimes running legal as well as financial risks. In April, a subsidiary of Deutsche was fined by Britain's Financial Services Authority for trading ahead of a client, without informing it, to “pre-hedge” a portfolio trade. Deutsche is also being investigated for possibly misleading clients on the placement of shares in Scania, a truck maker. This month, the administrators of Parmalat sued Deutsche, among others, for seeking payment ahead of other creditors two weeks before the Italian food giant's collapse last December. The damage to its reputation matters more to Deutsche Bank than rivals because its pockets are shallower and its spread of businesses narrower.

True, over the past two years, Deutsche has increased its earnings per share from €0.6 in 2002 to €2.83 in the first half of 2004. Alas, however, the market capitalisation of the bank has shrunk from €55 billion at the end of 2000 to €31 billion today. The bank is a leader in several businesses, but not many of them involve clients. In mergers and acquisitions, Deutsche Bank has barely improved its league-table position recently. And it lacks a convincing presence in America.

A “passion to perform”, Deutsche Bank's current slogan, does not translate into much more than a passion to make money for its investment bankers. Two banks which previously lived by that motto barely survived: Bankers Trust, which made a practice of putting clients second, was forced by regulators to merge with Deutsche Bank in 1999; and CSFB, which carried on the tradition until a regime change in 2001.

Deutsche is much less than it could be. While trying to broaden its horizons, it has shrunk them; by going global, it has ceased to be local. A bold merger in the home market would at least give the bank a firmer footing. Mr Ackermann seems unwilling or unable to deliver this. His supervisory board may soon find someone who can.

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About sponsorship

Japanese banks

Hostile towards whom?

Aug 26th 2004 | TOKYO
From The Economist print edition

Sumitomo Mitsui makes an impolite, but generous, bid for UFJ

Get article background

A capital purchase?
Japan's top banks, end March 2004, %

	Capital ratio	Non-performing loans as % of assets
Mizuho	11.35	4.80
MTFG	12.95	3.09
SMFG	11.38	5.60
UFJ	9.24	8.50

Source: *The Banker*

SET THE bar low enough, and even Japanese bankers can find a way to flop over it. That is how, on August 24th, Sumitomo Mitsui Financial Group (SMFG) managed to turn a ¥3.2 trillion ($29 billion) offer for UFJ—a bid that may not be serious and might not be accepted—into a soaring leap for Japan's financial-services sector.

SMFG has been trying for weeks to convince UFJ that it would make a better merger partner than Mitsubishi Tokyo Financial Group (MTFG), with which UFJ signed a merger agreement in July. MTFG and SMFG are Japan's second- and third- largest banks, behind Mizuho, and either would become the world's largest bank if it could get its hands on UFJ's assets.

But UFJ, which signed its agreement with MTFG even though MTFG had not placed a clear value on its offer, has continued to rebuff SMFG's advances. So SMFG decided to clarify the decision for UFJ's shareholders, almost a third of whom are foreign, by setting out some numbers. SMFG says that it will exchange its own shares with UFJ's on a one-for-one basis, which would value UFJ at a 23% premium to the bank's shares on the day the bid was announced.

It is not yet clear whether UFJ's managers will be compelled, or even want, to run this offer past their shareholders. But even if SMFG's bid does not succeed, it has been hailed by value-minded investors and pundits as a sign of progress. Before SMFG put some numbers on the table, says Richard Jerram, of Macquarie Securities, its battle with MTFG had been "more like two children squabbling over a toy than a competitive bidding process." And if it turns into a genuinely hostile bid—the first for a big bank—the offer would also signal that Japan's stockmarket is finally turning into a market for corporate control.

Whether it is a sensible bid is another matter. It is, of course, splendid for UFJ. Both MTFG and SMFG are well-capitalised and have cut their bad loans; both could thus offer UFJ the capital it seeks. UFJ ran into trouble earlier this year, when Japan's regulators caught its managers lying about the quality of its loans. They are putting UFJ under intense pressure to reduce its bad loans by next March, and will be very cross if they catch the bank doing this by cooking its books. In exchange for a merger agreement, MTFG and SMFG have each offered capital injections of up to ¥700 billion by the end of September, when UFJ must close its mid-year accounts.

In a proper bidding war, UFJ would go to whichever bank could add the most value, a question that has barely surfaced in the five-week-long spat. Like UFJ, SMFG has an extensive network in the big industrial centres of Osaka and Nagoya; and both banks are already strong in retail and small-business lending. That offers opportunities for cost cutting, which has created the most value in mergers elsewhere.

Many bank analysts reckon that Japan is different, however, because its big banks already have low costs. What they need to do is boost revenues. That is what MTFG wants to do. It views UFJ's strength in consumer banking as a quick way to turn itself into a fairly balanced, full-service bank. Whether or not this strategy is the right one, it is clearly more appealing to UFJ's managers. And since MTFG has a higher capital ratio and fewer bad loans, UFJ can probably get by with a slightly less painful overhaul of its loan book if it sticks with its first love. By making a generous offer, however, SMFG will make it more awkward for UFJ and MTFG to plough ahead without answering hard questions.

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Currencies

Nought to worry about

Aug 26th 2004
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Zeroing on too many zeroes

THE countries are disappearing fast where a man can make a million in an afternoon and then blow it all on an evening's drinking. Take Turkey, where you need to be a local-currency millionaire even to buy a good cup of coffee at the current exchange rate of 1.8m Turkish liras to the euro. A redenomination on January 1st 2005 will strip six zeroes from the currency, creating a “New Turkish lira” worth more like 1.8 to the euro. That promises some expensive mistakes for anyone who neglects the difference between old and new exchange rates after a night at the pub.

By Turkey's own count, it is the 50th country to pursue a redenomination in recent years. The move is meant to make the mathematics of currency transactions easier, and to erase the evidence of past inflation in the hope of deterring its return. Turkey has cut its inflation to perhaps 11% this year, from 53% in 2001. But three decades of cheapening money have debauched the lira so much that households routinely think in billions, and banks in trillions or even quadrillions. All those zeroes mean “problems in accounting and statistical records, data processing software and payment systems”, says the Turkish central bank, which calls the redenomination “psychologically and technically essential”.

Romania also wants to break ranks with the countries where you take a shopping-bag to the money-changer. It will cut four zeroes from its currency, the leu, in July 2005. Romania, too, thinks high inflation is behind it. It wants to join the European Union in 2007 with banknotes that other countries can take seriously. Its neighbour, Bulgaria, also a candidate for EU entry, cut three zeroes from its currency in 1999.

Even in Afghanistan, where the money was not even funny under the Taliban, the banknotes are worth substantially more these days than the paper on which they are printed. In January 2003 the government introduced a new “afghani” worth a thousand old ones. A euro buys about 52 afghani now, against 70,000 of them before the switch. At this rate, South Korea will soon find itself an international oddity with its exchange rate of 1,400 won to the euro. How about a redenomination there to transform the OECD's lightest currency into its most confusing—one won to one euro?

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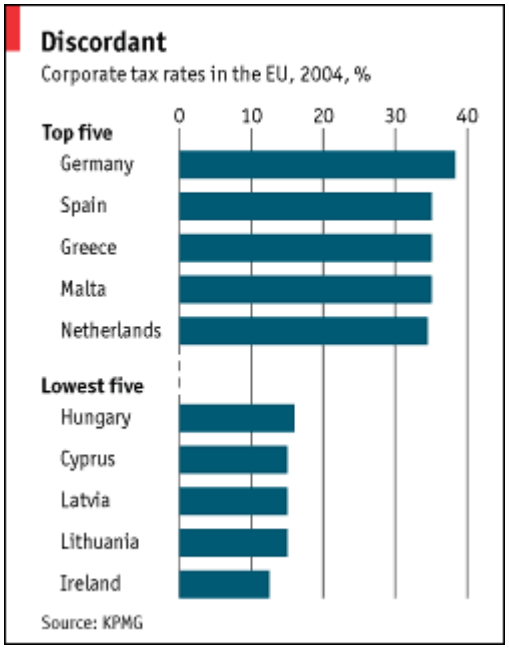
Corporate tax and the EU court

Taxing judgments

Aug 26th 2004
From The Economist print edition

Court rulings are forcing the pace of EU tax harmonisation



WHILE European Union governments do their best to avoid harmonising taxation, the EU's court of justice is busy doing it for them. Repeatedly, the court has ruled against national tax laws that discriminate between EU citizens on grounds of nationality, or hinder them setting up in other EU countries. Because these rulings also apply to companies, the effect has been to force governments to begin to alter, and in effect harmonise, tax laws.

Sometimes the result is to hit purely local companies with the same rules as multinationals. Thus, in Britain, transfer prices of goods or services between a London head office and its subsidiary in, say, Dover, used to escape tax rules that applied if the subsidiary were in Calais. Now, to pre-empt a hostile EU ruling, the law has been altered, for all but smallish firms, to catch purely British transactions too.

Much the same has happened with rules on “thin capitalisation”. This is the term used when a multinational finances its subsidiary in a high-tax country with debt, rather than equity, and charges a fat rate of interest. This shifts profit from the subsidiary to the parent, and high-tax countries naturally had rules against it.

Germany was one such. Its taxmen refused to allow as an expense all the interest paid by the German subsidiary of a Dutch company, Lankhorst-Hohorst, to its parent. The Dutch went to the EU court, arguing that had both parent and subsidiary been German, the interest would have been allowed in full. In late 2002, they won. Numerous companies in Britain then launched a group action to reclaim tax they had previously paid. Germany and Britain have now altered their “thin cap” rules so that they apply to purely local firms and multinationals alike.

The Dutch government lost a similar case last September. Bosal Holdings, a Dutch car-parts firm, had set up subsidiaries in other EU countries. Could it charge the finance costs as an expense? No, said Dutch law, only for subsidiaries in the Netherlands. Wrong, said the EU court, and the Dutch had to alter their rules.

In these cases, the taxmen have hung on to their revenues by being tough to all alike. But what if Marks & Spencer, a British retailing group, wins its challenge to a law that prevents it offsetting its French subsidiary's losses against group profits, as it could have done if the loss had been made in Britain? An EU ruling is due soon, and M&S hopes to gain at least £30m ($55m). A raft of multinationals have brought a group action in Britain. It could cost the state billions. Yet changing the law to deny offset even for local losses would be a giant step.

Dividends too are at issue. Hoechst, a German chemical group now merged into Aventis, in 2000 won a challenge to Britain's “advance” tax on dividends from its subsidiary there. There is a new case from Finland, whose law gives shareholders credit for Finnish, but only Finnish, corporation tax paid by the company. Here too the taxmen can expect to lose.

The real Europe-wide stinger, though, is the de Lasteyrie case, brought by a Frenchman who moved to Belgium. In French law, this meant he realised certain capital gains (though he had not sold the shares

concerned) and must pay tax. No, he argued, that limits my freedom to set up in another EU country. Last March, the court ruled for him. The European Commission promptly said it would sue Germany if a similar German “exit tax” were not amended.

Of the 15 “old” EU countries, 12 have exit taxes. All are probably illegal. And that applies to firms as well as to individuals. In sum, any EU firm will soon be free—at least in tax terms—to shift to some low-tax EU country: Ireland, say, with its 12.5% corporate-tax rate, as against Germany's 38% or France's 34%. No wonder those two high-taxers are keen on harmonising corporation tax—at some level, that is, nearer their own.

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Agriculture and banking

Against the grain

Aug 26th 2004 | NEW YORK
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Why is a Dutch bank moving into agricultural finance in America?

Alamy

A cloth of gold

WHAT on earth is Rabobank up to? This Dutch co-operative bank has been busily expanding its franchise in farm-finance, an area American banks have done everything to avoid since a meltdown in the 1980s. If that was not odd enough, Rabobank's most recent move is truly unique. At the end of July, it reached an agreement to buy Farm Credit Services of America, an institution that is a component of America's odd network of government-sponsored entities (GSEs). That agreement has unleashed an unholy row.

These financial institutions, including the well-known housing-finance giants Freddie Mac and Fannie Mae, enjoy the implicit backing of the US Treasury, and thus low funding costs, as well as tax breaks. All of these advantages would be lost if Rabobank's purchase goes through.

But no GSE has ever before agreed to a buyout. And soon after Rabobank's offer, a backlash began. A sister institution in Minnesota made a counter-offer backed by a lobbying group representing other government-backed farm lenders. Two American Senators have called for Congressional hearings. Concerns have been voiced about whether the sale of Farm Credit Services could weaken the overall farm-credit system: might a foreign buyer be less sensitive to local conditions? The biggest question is, however, unlikely to be raised: whether the offer for Farm Credit Services means that, finally, it is time to scrap the GSE system entirely. “The reason the farm-credit system came into existence is that no one else would provide credit,” says Ray Goldberg, a professor at Harvard Business School. “Now someone else will.” The same argument, it will not have gone unnoticed, applies to Fannie and Freddie.

Founded in 1916 as the first of the GSEs, the farm-credit system is now over-regulated and fragmented. It encompasses about 100 different financial institutions with $95 billion in assets. Farm Credit Services is one of the largest, with almost $8 billion in assets drawn from just four states: Nebraska, South Dakota, Iowa and Wyoming. It initiated the sale to Rabobank, and will pay heavily to ensure it goes through. It currently has a net worth of $1.3 billion, and will pay a fee of $800m to leave the overall farm-credit system. Rabobank will then pay $600m, or a bit more than the remaining book value, with the proceeds distributed to the shareholders of Farm Credit Services, who comprise most of its customers.

It is easy to see the deal's logic for each side. The odd four-state limitation for operations means that Farm Credit Services has increasingly run into problems servicing customers whose operations have expanded into adjacent states or even internationally. By law, moreover, Farm Credit Services is unable

to take deposits. If its acquisition goes ahead, these and other restrictions would be lifted.

For Rabobank, the acquisition is a small piece of a larger plan. Since 2002 it has purchased a bank in California, covering the farming areas from Fresno to the Mexican border; an agricultural-land finance company in St. Louis; and an Iowa-based farm-credit institution. And Rabobank would like to make further acquisitions that would give it better access to meat processors and breeders in the south, as well as tomato- and citrus-growers in the southeast. It has an agreement with government-controlled banks in western Canada that could lead to an acquisition there, and has become a huge force in the agricultural-banking markets of Australia, New Zealand and Ireland. It plans to expand in emerging economies, too.

Such enthusiasm is less odd than it looks. True, agriculture is notoriously cyclical and has been shrinking as a percentage of the global economy for years—not very attractive features for lenders. But a powerful niche player could overcome these obstacles. And it can sell derivatives to farmers attempting to hedge weather and price fluctuations. Rik van Slingelandt, head of Rabobank's international operations, says that, with the farming industry consolidating globally, farmers will want a global financial institution.

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Economics focus

Counting heads

Aug 26th 2004
From The Economist print edition

A breakthrough in measuring the knowledge economy

TO WHAT extent is economic growth driven by the acquisition of “human capital”? Many economists have pursued the answer over the past 20 years, but without great success. Despite building and rebuilding elaborate growth models, they have failed to prove that better education and training significantly raises a country's long-term growth. Recently, though, a Canadian team made a breakthrough. It found that, if you measure actual skills rather than educational qualifications, human capital becomes a strong predictor of economic growth.

For individuals, the rewards to education are clear: those with higher qualifications earn, on average, far more over a lifetime than the less qualified. But studies of whole economies over time have found only weak evidence that high or rising completion rates of secondary or university education are associated with stronger growth. The most marked effects, unsurprisingly, show up in comparing more and less developed countries; for countries at similar stages of development, there is no consistent evidence that education makes a difference to growth.

One possibility is simply that human-capital theories are flawed. If education acts as a signalling or sorting device, allocating better-qualified individuals to better jobs rather than improving the overall productive capacity of the population, then individual gains from education need not add up to collective gains. Yet micro-studies of skills and productivity have long shown that acquiring certain defined competencies not only confers advantages on individuals but also raises productivity.

Another explanation is that economists were measuring the wrong thing. Having a high-school diploma or university degree is a weak indicator of whether one has skills that increase productive capacity. Educational qualifications may be relatively easy to measure, but offer only a poor proxy for human capital. What one wants is a direct measure of economically relevant skills. The 1990s saw a step in this direction, with the development of a new form of testing that assesses the extent to which young people and adults in different countries acquired certain key competencies required for work and everyday life. These centre on measures of literacy, understood in the widest sense as the ability to use different kinds of written material to perform real-world tasks of varying complexity. This is the kind of general competency that the micro-studies find to be closely linked to productivity.

It will be 20 years or so before analysts can use these new human-capital indicators to track the long-term effect on growth of having people with more or fewer skills entering work. However, a team of economists at the University of Ottawa, working with Statistics Canada, has found a clever short-cut allowing them to gauge this human-capital effect now*. They use the International Adult Literacy Survey, which tested 16-65-year-olds in the mid-1990s, to estimate the skills of people in 14 countries entering the workforce at different times between 1960 and 1995. This is achieved by looking at tests of different age cohorts. For example, the literacy levels of people aged 52-60 when tested in 1995 are used to estimate the competencies of 17-25-year-olds in 1960, and hence the human-capital investment that had just been made in the course of that cohort's education.

The team identified a clear and significant association between investments in human capital in each period and a country's subsequent growth and labour productivity. Specifically, a rise of 1% in literacy scores relative to the international average is associated with an eventual 2.5% relative rise in labour productivity and a 1.5% rise in GDP per head.

These are much clearer effects than those found in previous studies. In the three countries in the study where human capital improved the fastest between the older and the younger generations (Belgium,

Finland and Italy), growth in output per worker rose much faster than average between 1960 and 1995, while in those with least improvement in skills (New Zealand, Sweden and the United States), growth was slower.

Seeking potential

This analysis also sheds light on the nature of the link between human-capital improvements and economic growth. For instance, the benefit of reducing the number of people with very low skills shows up more clearly than that of increasing the number with the highest skills. This does not mean that the supply of highly skilled personnel is irrelevant to growth: the survey may be incapable of picking up the kinds of talents that drive the top end of knowledge economies. However, the results do indicate that these are not the only skills that drive growth. Raising the basic skills of the whole population can bring tangible macroeconomic gains that can help justify the cost of remedial literacy programmes.

Another finding is that raising women's literacy improves productivity more than raising men's. One reason is that women have been undervalued in the past, making gains in literacy more powerful in unlocking potential than comparable gains for men. A second possibility is that more low-skilled men are in manual jobs where human capital has fewer economic benefits.

The Canadian study provides only a rough measure of the human-capital effect. Its biggest flaw is that testing adults today gives an imperfect idea of what skills they brought into the workforce many years ago. However, the fact that it finds such a strong correlation between skills and growth gives a significant boost to human-capital theory, and to the view that investing in skills brings long-term economic rewards.

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* Literacy scores, human capital and growth across 14 OECD countries. By Serge Coulombe, Jean-François Tremblay and Sylvie Marchand. Published by Statistics Canada.

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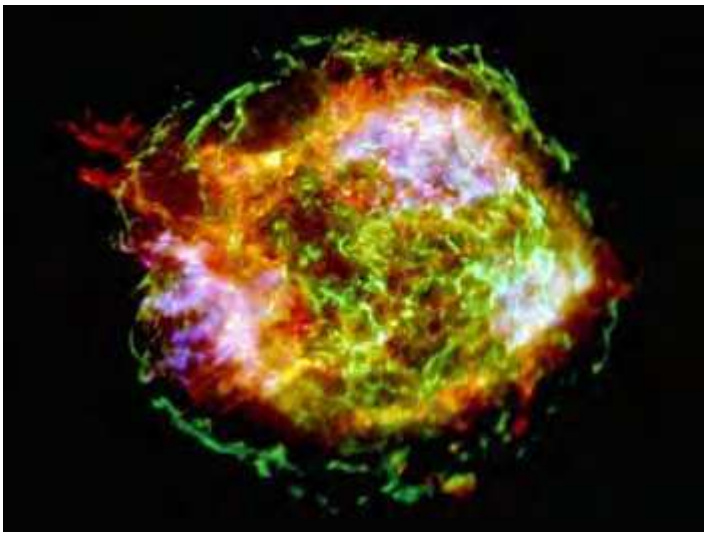
About sponsorship

Space telescopes

X-ray specs

Aug 26th 2004
From The Economist print edition



Two of NASA's flagship satellites celebrate their birthdays

IN 1680, the light from a supernova (a massive, exploding star) in the constellation of Cassiopeia reached Earth. Surprisingly, the event went almost unnoticed. It was recorded—and then only in passing—by John Flamsteed, England's first astronomer royal. After that it was forgotten until astronomers started to examine the sky in frequencies of the electromagnetic spectrum other than the light that is visible to the human eye. At that point somebody had the idea of building a radio telescope. Cass A, as the remnant of the supernova of 1680 is now known to astronomers, turned out to be the brightest radio source in the sky, other than the sun.

The history of Cass A is a lesson in the need to look at the universe in as many different ways as possible, in order to build up a complete picture of what is going on. And this month sees the anniversaries of two scientific instruments designed to do just that. *Chandra* and *Spitzer* are satellite telescopes designed to look, respectively, at the X-ray and infra-red parts of the spectrum. *Chandra*'s first pictures were sent back to Earth five years ago, and *Spitzer* has just celebrated its first birthday. Together with *Hubble* (which looks at visible light) and *Compton* (which studied gamma rays, the most energetic part of the spectrum, until its mission ended and it was “deorbited” in June 2000), these two satellites are part of the “Great Observatories” programme organised by NASA, America's space agency.

Thy candles shine out brightly

After its inauspicious start as an unregarded entry in Flamsteed's catalogue, Cass A is now a popular subject of study. Indeed, it was the first object that *Chandra* took a picture of. And it has turned out to be a powerful source of X-rays, as well as radio waves. This week, *Chandra*'s handlers released a new picture of Cass A—a 1m-second exposure (pictured above, with the different X-ray frequencies rendered as different colours) that is 200 times more detailed than the first, test image.

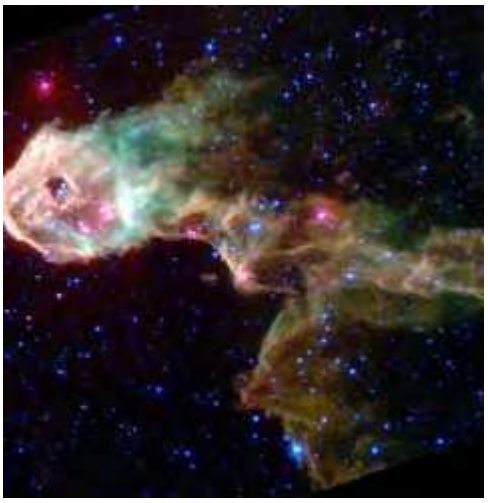
What is remarkable, according to Harvey Tananbaum, the director of the *Chandra* X-ray centre, in Cambridge, Massachusetts, is that until *Chandra*, no one had seen the star at the centre of Cass A—the source of the explosion. That is partly because it is obscured by the gaseous nebula ejected in that explosion. But it is also because it is—as became apparent when *Chandra* eventually did find it—between a tenth and a hundredth as bright as theory predicted. Furthermore, *Chandra* found that heavy elements

in the nebula (iron, silicon and the like) were much more mixed together than theory suggested they should have been. All of this shows that understanding of supernovae has a long way to go. And that, in turn, bears on understanding of how planets form, since supernovae are believed to be the main source of the elements that make up rocky bodies such as the Earth.

Planet formation is also one of the areas that *Spitzer* is being used to study. As Mike Werner, the *Spitzer* mission's chief scientist, puts it, the satellite is seeking to answer two specific questions: “where did we come from, and are we alone?” To answer the first, *Spitzer* looks at distant galaxies. To answer the second, it looks at young stars and their associated gas and dust—the material from which planets form.

In June of this year, *Spitzer*'s scientists announced that they had seen the most distant galaxy yet discovered. In astronomical terms, distance translates into time, because of the time that light takes to travel from an object to Earth. This most distant galaxy is therefore also the youngest known. It dates from a mere 600m years after the Big Bang in which the universe came into existence. That is earlier than many cosmologists had thought possible. Although this galaxy had been glimpsed by *Hubble*, that telescope had been unable to see any of the oldest stars in it—ie, those which set a limit on its age. Old stars tend to be redder than young ones, and in distant objects that redness is converted into infra-redness by a phenomenon called red-shift. This is caused by the expansion of the universe, which means that distant objects are whizzing away from the Earth at a terrific clip. The Doppler effect (think passing police sirens) changes the frequency of light received from these receding objects in a redward direction.

Spitzer's other mission, examining the circumstellar nebulae that are the birthplaces of planets, also plays to its strengths. At the infra-red frequencies at which *Spitzer* looks, the light from the dust overwhelms that from the star. That means it is possible to examine a nebula without being blinded. *Spitzer* has already looked at hundreds of such nebulae, of different ages. The data thus collected should allow the process of planet formation to be followed from beginning to end.



Spitzer's view of a stellar nursery

Dating early galaxies and the study of circumstellar nebulae are triumphs for *Spitzer* alone. But part of the value of having telescopes that see the universe in different ways lies in using them together. One such collaboration is GOODS, or the Great Observatories Origins Deep Survey, in which *Spitzer* worked with *Chandra* and *Hubble* to look in detail at a small patch of sky. The most striking delivery of GOODS so far, also announced in June, was the imaging of a number of distant supermassive black holes. Theorists had long predicted such things would exist, but observers had been unable to find them. *Chandra* picked out high-intensity X-ray sources, which were then photographed by *Spitzer* because the dust surrounding them prevents visible light from getting out.

Nothing, of course, lasts forever. Indeed, *Hubble* is approaching the end of its life, unless it is given a refit (a subject of much anguish inside NASA). Dr Werner estimates that *Spitzer* has at least five more years of useful life in it. After that, the liquid helium used to cool its instruments will run out. *Chandra* should last longer, since it does not need cooling. In the meantime, Happy Birthday to both.

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Computing

From factoids to facts

Aug 26th 2004 | REDMOND, WASHINGTON
From The Economist print edition

At last, a way of getting answers from the web

WHAT is the next stage in the evolution of internet search engines? AltaVista demonstrated that indexing the entire world wide web was feasible. Google's success stems from its uncanny ability to sort useful web pages from dross. But the real prize will surely go to whoever can use the web to deliver a straight answer to a straight question. And Eric Brill, a researcher at Microsoft, intends that his firm will be the first to do that.

Dr Brill's initial crack at the problem is a system called “Ask MSR” (MSR stands for Microsoft Research). This program uses information on web pages to respond to questions to which the answer is a single word or phrase—such as “When was Marilyn Monroe born?” Ask MSR starts by manipulating the question in various ways: by identifying the verb, for example, and then changing its tense or moving it into different positions in the sentence (“Marilyn was Monroe born”, “Marilyn Monroe was born” and so on). The resulting phrases are then fed into a search engine, and documents containing matching strings of words are retrieved. It sounds a promiscuous strategy, but gibberish phrases produce few matches, so, as Dr Brill puts it, “being wrong is very cheap.”

Once accumulated, the pile of documents is scanned for possible answers, and these are ranked by frequency. In practice, the correct answer appears in one of the first three places around 75% of the time. That might not sound very good, but human intelligence provides a second filter, since wrong answers are often obvious. If you ask how many times Bjorn Borg won Wimbledon, for example, “1980” is not a plausible answer, but “5” is. If in doubt, clicking on an answer produces a list of links to pages which provide support for that answer.

Ask MSR is still a prototype, although Microsoft is trying to improve it and it may be launched commercially under the name AnswerBot. Dr Brill, meanwhile, has moved to a more difficult task. One of his most recent papers, written jointly with Radu Soricut of the University of Southern California, is entitled “Beyond the Factoid”. It describes his efforts to build a system capable of providing 50-word answers to questions such as “What are the rules for qualifying for the Academy Awards?” This is harder than finding a single-word answer, but Dr Brill thinks it should be possible using something called a “noisy channel” model.

Such models are already employed in spell-checking and speech-recognition systems. They work by modelling the transformation between what a user means (in spell-checking, the word he intended to type) and what he does (the garbled word actually typed). Just as a telephone line distorts the voice of the person at the other end of the line, this process can be thought of as being a noisy channel that transforms the user's intention into something rather different.

By analysing many pairs of correct and mis-spelled words using statistical techniques, it is possible to predict how such transformations work in general cases. A system can then be designed to work the process backwards. Given a mis-spelled word, it can guess what that word is most likely to be a mis-spelling of.

Dr Brill's question-answering system does something similar. Many question-and-answer pairs exist on the web, in the form of “frequently asked questions” (FAQ) pages. Dr Brill trained his system using a million such pairs, to create a model that, given a question, can work out various structures that the answer could take. These structures are then used to generate search queries, and the matching documents found on the web are scanned for things that look like answers.

The current prototype provides appropriate answers about 40% of the time. Not brilliant, but not bad.

And it should improve as the web grows. Rather than relying on a traditional “artificial intelligence” approach of parsing sentences and trying to work out what a question actually means, this quick-and-dirty method draws instead on the collective, ever-growing intelligence of the web itself.

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Solar science

Inheriting the wind

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A capsule containing part of the solar wind is due to make a dramatic fall to Earth

ACCORDING to Homer, Odysseus was given a bag containing the wind to help him on his journey home from Troy. Unfortunately, his crew opened it and his ship was blown off course. America's space agency, NASA, will be hoping a similar fate does not befall its *Genesis* mission, which is due to return a container of solar wind (material which streams off the surface of the sun) to Earth on September 8th. This will be the first time a sample of any kind has been collected by a spacecraft and brought to Earth since the astronauts of *Apollo 17* took rocks from the moon in 1972.

Genesis has spent 884 days sitting at a place called the Lagrange 1 (L1) point, beyond the orbit of the moon. At L1 the gravity of the sun and the Earth are balanced, allowing *Genesis* to remain at a spot where the solar wind blows at full force. Once at L1, the craft spent its time collecting particles of that wind in an array of wafers made of diamond, sapphire, silicon and gold—substances from which those particles can easily be extracted.

The purpose of *Genesis* is to investigate the isotopic composition of the sun. Isotopes are atoms of the same chemical element that have different numbers of neutrons in their nuclei, and thus different atomic weights. Isotopic analysis of rocks from the Earth, the moon and various meteorites has shown that the ratio of certain isotopes varies from place to place in the solar system. Understanding the details of that variation would cast light on the early days of the solar system—a time when it was a cloud of gas and dust (see article).

At the moment, knowledge of this period is sparse. Knowing the isotopic composition of the sun would be a big step forward. It would give a baseline from which a picture of the chemistry of the early solar system could be drawn, allowing researchers to work out how different parts of the primitive solar cloud mixed or, rather, failed to mix.

Unfortunately, the wafers are extremely fragile—and as anyone who has gone sky-diving can attest, parachute landings are not soft. That has given NASA an excuse for the kind of public-relations spectacle at which it excels. Instead of letting the sample-return capsule make a possibly damaging landing, it is to be snagged in mid-air by a helicopter flown by a Hollywood stunt pilot.

On the morning of the capture, *Genesis* will fly past the Earth and release the capsule, sending it on a course to enter the atmosphere above Oregon. Once beyond the searing heat of re-entry, it will deploy a funnel-shaped parachute and then a parafoil. It will then descend to the pick-up site, south-west of Salt Lake City. There, two helicopters will await its arrival.

One of these helicopters will attempt to snag it using a pole with a “space-age fishing hook” on the end. If that fails, the second helicopter's crew will have a go. And if they fail, the first crew will come back. And so on. With a bit of luck, this game of aerial leapfrog will catch the capsule before it hits the ground, and the solar system's youth will become a little less mysterious as a result.

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Birdwatching

Peace, prosperity and anoraks

Aug 26th 2004 | RUTLAND WATER
From The Economist print edition

The money in birds

GUMBOOTS, anoraks and woolly hats converged on Rutland Water in Leicestershire last weekend for the world's largest birdwatching fair. In their thousands, bird enthusiasts peered through expensive telescopes, toured stalls offering birdwatching holidays and listened to lectures on projects that are creating jobs as well as saving habitats.

Britain is particularly big on what Americans call “birding”. The Royal Society for the Protection of Birds, which helps to run the fair, has over 1m members—twice as many as America's National Audubon Society—and is Europe's largest wildlife-conservation charity. But on both sides of the Atlantic, birdwatching is not just popular, it is also big business. The Rutland Water fair, now into its 16th year, turns over around £3m ($5.4m) in three days. Much of that comes from holidays—the fair, says Tim Appleton, who runs the Rutland Water nature reserve, is now the world's most important event to promote ecotourism. But stay-at-homes spend money too. In America, a magazine called *Birding Business* is full of ingenious ways to market bird food (“Great packaging wows the customers and can double or triple sales volume,” promises one piece) and the latest designs in garden bird-feeders.

For companies making field glasses and telescopes, the birdwatching boom is a blessing. It has offset the stagnation or decline in game-hunting. Swarovski, an Austrian optical-equipment company, estimates that the number of serious birdwatchers in America is now somewhere between 7m and 15m. That puts them on a par with the number of hunters (around 10m). But the hunting market for optical goods has been flat for two decades, whereas sales of equipment to birdwatchers are growing by around 5% a year, in real terms. In Britain, too, things are on the up. Swarovski says that sales of its optical equipment made through specialist birdwatching dealers have been rising for a decade. Sales made through hunting dealers, by contrast, are smaller and shrinking.

Other countries are starting to get the message. In Italy, says Marco Lambertini of BirdLife International, the number of hunters has fallen from 3m in 1971 to 600,000 last year. The country's first birdwatching fair, held this spring, attracted 25,000 visitors. In Israel, Yossi Leshem, an enthusiastic bird lover, has found another use for birds. He has created a series of joint projects with Palestinian and Jordanian birdwatchers, to monitor the migrating birds which pour through that part of the Middle East twice a year. Birds, of course, do not recognise national frontiers.

The most passionate birdwatchers, known as “twitchers”, are earnest folk who pursue a rare bird to add it to a list. Stephen Moss, in a new history of birdwatching*, describes the fury of British farmers when large crowds, composed mainly of young men, trample across their fields in search of some storm-tossed migrant. One farmer sprayed twitchers with pig manure. In America, though, the locals seem friendlier—and also cannier. Richard Payne, chairman of the American Birding Association, describes how a small town in Texas earned more than $2m in six weeks last spring, thanks to the arrival of some migrating birds.

* “A Bird in the Bush: a Social History of Birdwatching”. Aurum Press. London.

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About sponsorship

Russian cinema

Not since Battleship Potemkin

Aug 26th 2004 | MOSCOW
From The Economist print edition

Home-made movies are beginning to attract big audiences again

ONCE again Russia is fighting off an invasion from the West. But this time the battle is taking place in the country's cinemas. Until recently, Russia's highest-grossing film was “The Return of the King”, the third instalment in “The Lord of the Rings” trilogy. But this month that record was broken by a local blockbuster: “Night Watch” has earned around $15m since it opened in mid-July. Together with a couple of successful “avenging cop” movies (“Anti-Killer” and “Anti-Killer 2”), which came out in 2002 and 2003, the film heralds a new vitality in Russian cinema. A few years ago the industry had seemed to be heading for commercial oblivion.

In the Soviet era, cinema was officially considered the most important of art forms, and government funding was readily available for high-brow, non-commercial projects. Serious artists commanded great social respect as official dreamers of the revolution. But when the Soviet Union fell, the cultural intelligentsia failed to adapt to the new commercial reality. Film-makers insisted on producing long, obscure films with titles such as “It's Impossible to Live Like This”—not natural hits at the box office.

The films continued to do well on the international festival circuit, but domestic cinema attendance rapidly fell to the lowest level in Europe. In the 1980s, Russians went to the cinema on average 16 times a year; by 1995 that had fallen to one visit a year for every four Russians, one-quarter of the rate in central Europe. One director, Konstantin Lopushansky, said that if it were not for the retrospectives of his films abroad, and invitations to sit on the jury of major foreign film festivals, he would “certainly be dead from hunger”.

The void was filled with cheap imports. In particular, Russians fell in love with gaudy TV soap operas from Latin America, with titles such as “Love Without Limit” and “The Rich Also Cry”. The old guard of Russian writers, actors and directors looked with increasing jealousy at these tacky capitalist products that could command such huge audiences, and slowly they began to compete.

Boris Akunin, for example, a distinguished philologist and deputy editor of a literary magazine, became a bestselling author of detective fiction. He says he turned to the genre when he saw his wife reading a pulp-fiction novel on the Moscow underground, guiltily hidden behind the cover of a high-brow classic. Someone, he decided, needed to write popular fiction that people like his wife would not be ashamed to read in public.

Russian television channels began to turn out slick cop-and-gangster series, such as “The Brigade” and “Lethal Power”, and they used some of the best actors from the traditional theatre. Konstantin

Khabensky, for instance, started off as a respected theatre actor before starring in “Lethal Power”. Then he turned to the cinema and he is now the star of “Night Watch”.

The hit movie is an old-fashioned cosmic battle between good and evil. It is making money partly because it displays the commercial savvy which earlier Russian films so conspicuously lacked. Its director, Timur Bekmambetov, made his name in advertising and he has a good feel for product placement. Nescafé, Nokia and MTS, a mobile-phone operator, all feature prominently among the film's props.

“Night Watch” is also the first Russian movie to have a properly organised marketing campaign, partly thanks to the support of the state-owned television channel, Channel One, which co-financed the production. It also had a tie-in with the book, which had come out before the film but was re-released to capitalise on the movie's popularity. Moreover, like any good movie franchise, it is to be the first of a trilogy. The second instalment, “Day Watch”, is due next year.

A taste of pelmeni

But perhaps the main reason the film is doing so well is that it has a genuinely Russian element. As with Russia's speeded-up adoption of so many capitalist ways, the placing of western templates on local reality and thinking can produce strange combinations. Half-way through a violent tussle with a vampire in “Night Watch”, for example, the heroes stop for a bowl of *pelmeni* (Russian dumplings). As one Russian movie-goer says proudly: “It shows we can make blockbusters just like Hollywood”—equally impressive special effects and absurd plot, but with a Russian twist.

These home-groomed products are now set on competing abroad. Mr Bekmambetov has just sold the foreign distribution rights to “Night Watch” and “Day Watch” for $4m, while Mr Akunin's first novel, “The Winter Queen”, is likely to be made into a film by Paul Verhoeven, the Hollywood director of hits such as “Basic Instinct” and “RoboCop”. Mr Verhoeven says he is thinking of “The Winter Queen” as “‘Basic Instinct' set in 1876”. That could mean big sales in any language.

Russian cinema is still producing quality high-brow products. “The Return”, for example, a typically grim tale of filial resentment, won the Golden Lion award at the Venice film festival last year, while “Russian Ark”, a gorgeous film set in the Hermitage museum, has found many admirers among the international arthouse crowd. But such demanding fare, in Russia as in the rest of the world, cannot for long be the only dish on offer.

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About sponsorship

Tamerlane

Lame but never halting

Aug 26th 2004
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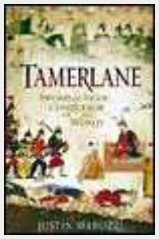
HIS trademark was a pile of skulls, formed from the slaughtered inhabitants of cities that resisted him. He launched a fresh military campaign almost every spring, riding south one year to sack Delhi, then west to the shores of the Mediterranean, destroying every monument in Baghdad on the way, before setting off to loot Peking. The vast empire he established—though the term suggests an administrative unity it never possessed—started to disintegrate on the day of his death in 1405; 100 years later it had vanished entirely. To one historian, he represented the "supreme example of soulless and unproductive militarism" until the advent of Hitler.

Tamerlane: Sword of Islam, Conqueror of the World
By Justin Marozzi



HarperCollins; 449 pages; £25

Buy it at
Amazon.co.uk

Despite this zeal for destruction, Justin Marozzi finds a surprising amount of good to say about the Central Asian conqueror usually known in the West as Tamerlane or Tamburlaine, a corruption of Temur-i-lang, or Temur the Lame—not a name that anyone, surely, would have dared use to his face. Compared with his Central Asian empire-building predecessor, Genghis Khan, Temur emerges as not without virtues. He was a lavish patron of the arts and he was a tremendous builder, as the splendours of his capital, Samarkand, attest—though the finest of that city's monuments were built by his descendants.

True, his methods were not always the most refined: when he returned to Samarkand after a hard few years slaughtering enemies, he felt that the portal of his new mosque was insufficiently lofty. So he had it torn down and its supervisors executed. But butcher or builder, the West has reason to be grateful to Temur. In 1402, he turned on, and defeated, the Ottoman Turks, thus giving Christendom a breathing-space after the crushing defeats inflicted on it by the Ottomans at Kosovo in 1389 and Nicopolis seven years later.

If at times irritatingly like an apologia for a bloodthirsty tyrant, Mr Marozzi's book has a gripping tale to tell. It traces Temur's rise from obscurity in a small village in what is now Uzbekistan, but was then part of the fragmented Mongol empire. With a stunning series of campaigns, almost all of them directed against fellow Muslims, he first subdued Central Asia, then added to his dominions by conquering the Khanate of the Golden Horde, a vast territory stretching north into Russia and Ukraine, and the biggest of the Mongol fragments.

But if his aim was to re-establish that empire, he did not really manage it. The Khanate of the Golden Horde was held tenuously, and the effort to unseat the Ming dynasty in China (which had thrown out the Mongol Yuan dynasty founded by Genghis's grandson, Kubla Khan) failed with Temur's death. Even the conquest of northern India, a feat, so Mr Marozzi rather breathlessly assures us, that surpassed the achievements of both Genghis Khan and Alexander the Great, amounted to no more than a raid that destroyed a noble city and left tens of thousands dead.

Where the book scores highly, though, is in its reportage. This is not just a biography; it is also a travel book. Mr Marozzi has traced in person much of Temur's relentless campaign trail, and he elegiacally shows us how far Samarkand and Bukhara, once the most glorious cities in Asia, have descended. They now lie "in a neglected southern outpost of the old Soviet empire", and Temur is long forgotten. His birthplace is "an unprepossessing site, a pile of bricks on a concrete base, topped by an inscribed plaque, more like a poorly built barbecue than a monument to one of the world's greatest conquerors."

Tamerlane: Sword of Islam, Conqueror of the World.
By Justin Marozzi.

HarperCollins; 449 pages; £25

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About sponsorship

Western Sahara

Just deserts?

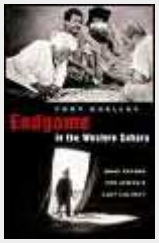
Aug 26th 2004
From The Economist print edition

IN 1991, after 16 years of guerrilla war between Morocco and Polisario, the Western Saharan independence movement, both sides officially agreed that a referendum should be held in the territory to decide whether it should be independent or integrated with Morocco. The UN sent a mission to identify eligible voters. But the process was, and remains, a farce. Morocco will allow a referendum only if it can stack the votes by including Moroccan settlers and other tricks that ensure a vote for integration. The backing of its friends, America and France (on the same side for once), enables Morocco to stall indefinitely.

Even when the whole sleepy business seemed to be given life by the appointment in 1997 of James Baker, a former American secretary of state, as the UN man in charge, little really changed. Mr Baker came up with a couple of ideas, one of them very friendly to Morocco. The UN Security Council endorsed the rather more balanced compromise last year. But did that signal an end to this unfinished bit of decolonisation? Given the intensity of feelings, probably not.

Endgame in the Western Sahara: What Future For Africa's Last Colony?

By Toby Shelley



Zed Books; 224 pages; $69.95 and £45 (hardback), $22.50 and £14.95 (paperback)

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Following the complex steps of the referendum minuet, Toby Shelley provides a detailed account of the region's history since 1975 when Spain, in Franco's dying days, allowed what was then Spanish Sahara to go, for an interim period, to Morocco and Mauritania (the latter dropped out during the guerrilla war). He acknowledges that Western Sahara, “a territory the size of France with a population the size of Lyons”, has no powerful allies. Algeria was staunch for a time but now has more important things on its mind; Spain has occasional qualms of conscience about deserting its charges; and ex-colonies empathise with the desire of the local people, the Sahrawis, for self-determination. But none of this, he argues, offsets the importance of Morocco to the West as a strategic ally and economic partner.

Mr Shelley holds out two possibilities. Western Sahara already has phosphates and fisheries, but the expected discovery of offshore oil might inject urgency: foreign companies will be reluctant to move in while the territory's status remains undecided. Second, he believes (or, rather, hopes) that social instability and economic frailty at home may alert Morocco to the expense and difficulties of occupation. He cites East Timor, whose independence was triggered by political and economic crises in Indonesia.

Reuters

How long until he fires in anger?

He compares the Sahrawis and the Palestinians. Morocco, like Israel, uses delay to change the facts, sending Moroccans to live in the territory. Like Israel's current “security barrier”, but on a far bigger scale, Morocco built a vast wall running 1,500 miles (2,400kms) along the Algerian and Mauritanian borders during the years of fighting. The state of Texas has a similar border with Mexico but, joked Mr Baker, a Texan, it cannot afford such a barrier.

The Sahrawis are divided between those who live under occupation in Western Sahara and Polisario's people, who were exiled to refugee camps in Algeria in the mid-1970s. Polisario, or rather the Sahrawi Arab Democratic Republic which it proclaimed in 1976, and which is recognised by some 60 governments, is the Sahrawis' official voice. But the camps are isolated and demoralised by

all the hanging about since the 1991 ceasefire.

So Mr Shelley looks instead to the Sahrawis in the territory to prepare for the independence battle by creating a strong civil society. All good luck to them. But for anything to happen peacefully, the world has first to push Western Sahara much higher up its over-loaded agenda.

Endgame in the Western Sahara: What Future For Africa's Last Colony?
By Toby Shelley.
Zed Books; 224 pages; $69.95 and £45 (hardback), $22.50 and £14.95 (paperback)

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About sponsorship

Ahmadou Kourouma

Birahima's last battle

Aug 26th 2004
From The Economist print edition

“WHEN someone says there is a tribal war in a country, it means that highway bandits have shared the country among themselves.” So explains Birahima, the orphaned street child and hero of “Quand on refuse on dit non”, the last novel by Ahmadou Kourouma. A sequel to the acclaimed “Allah n'est pas obligé”, Mr Kourouma's fifth novel—which has just been published in French—remains incomplete, interrupted by the Ivoirian writer's death in December 2003.

Quand on refuse on dit non
By Ahmadou Kourouma

Seuil; 160 pages; €14

Buy it at
Amazon.fr

Birahima knows a lot about tribal wars. Born in a “corrupted banana republic of Francophone Africa”, he becomes a child soldier in several countries. In the first of the two novels he travels through warring Liberia and Sierra Leone to find his aunt, and is hired by various warlords. His road companion, Yacouba, is a wheeler-dealer and a witch doctor.

In the sequel, Birahima is now living in a Côte d'Ivoire that is descending into ethnic madness. He is back on the road again, fleeing pro-government militias who are killing members of the northern Malinke tribe. He travels with Fanta, a young woman “as beautiful as a gouro mask”, heading for Bouake, a town under the control of northern rebels. On the way, Fanta teaches him about Côte d'Ivoire and the roots of its conflict.

Birahima tells his story in a unique mixture of erudite French, Malinke slang and local proverbs (with definitions for all of them in parentheses). The colour and structure are resolutely African. People can be ugly and dirty “as a hyena's anus”, and if Liberia is a simple mess, Sierra Leone is a “mess squared”.

Horror—with corpses “superbly damaged, a crushed skull, a ripped-off tongue, genitals finely chopped”—co-exists with irresistible humour. Portraits of demented warlords (and warladies) mingle with Birahima's unusual view of the world, to leave readers on occasions laughing out loud.

“Quand on refuse on dit non” is dominated by Fanta's lessons on Côte d'Ivoire, pushing the fictional element that was central to “Allah n'est pas obligé” into the background. The young woman explains the rise of the notion of “Ivoirité” which is fanning the flames of the conflict. “Today, Ivoirité means to be Ivoirian before other people,” remarks Birahima. “It is not to have bled for the motherland.” That land is now riddled with mass graves, whose compost, joyfully concludes the hero, “gives Côte d'Ivoire a rich soil that feeds good coffee, good bananas, good hevea and above all good cocoa.”

In the late 1960s, when African literature was dominated by tales of colonialism and slavery, Mr Kourouma was already an acerbic critic of the continent's post-independence governments. As a result, he spent most of his life outside his home country. With his death, African literature lost one of its best writers and most ferocious satirists, whose novels received numerous literary awards. Sadly, Birahima has been orphaned once again, and one can only wonder about the fate of his disintegrating Côte d'Ivoire.

Quand on refuse on dit non.
By Ahmadou Kourouma.
Seuil; 160 pages; €14

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About sponsorship

Cities

Of dreams and nightmares

Aug 26th 2004
From The Economist print edition

JOHN READER, a long-time writer and photojournalist, likes to write big books about big subjects, and this tome is no exception. It aims to explore two themes: how cities have arisen throughout the sweep of human history, and what their impact has been. For many residents of today's richer nations, the city is something to be endured and, preferably, left behind at weekends. There are shelves of books about pastoral pleasures; far fewer that take a serious look at the urban reality most of us confront every day. Mr Reader reminds us that, from early Mesopotamian settlements to modern-day slums, most human activity has taken place in cities.

Cities
By John Reader

William Heinemann; 358 pages; £20

Buy it at
Amazon.co.uk

Protection from invading enemies was one of the first reasons for the rise of the city. Then, when the production of surplus food allowed for the specialisation of labour, the economic benefits from the physical proximity of that labour became apparent. But the causal arrow might also have run the other way: powerful fortified cities could have provided incentives for farmers to improve agriculture.

Mr Reader's history is often told in the words of contemporary residents, and these are by far the best bits of the book. There is the Sumerian father urging reform on his prodigal son, who has been caught up in the pleasures of city life instead of preparing for a career—an adolescent rebellion that would have been impossible in a village. There are tales of financial swindles in Italian merchant cities, not unlike the shenanigans at Enron in modern-day Houston. A breakdown of trust and honesty happens more easily in a city, where sins can be hidden from anonymous or absent neighbours. This paradox, a feeling of isolation amid the city's crowds, was as recognisable in medieval Venice as it is in today's New York.

The phenomenon of city slickers invading the turf of country folk, if only for a summer holiday, also has well-established roots. Mr Reader quotes the rage of one English writer in the early 1800s at rich London traders who would breeze blindly past rural poverty, wife and children in tow, on their way to a holiday in Brighton. But migrating to the towns did not end poverty, as Berliners discovered during the first world war as they starved in slums that Mr Reader blames on the excesses of property speculators.

The book loses its way somewhat when it addresses the problems of modern “conurbations”. In 1800, 10% of the world's population lived in cities. Nowadays that figure is around 50% and growing, helped by relentless migration to places such as Jakarta and São Paulo. Inequality, disease and environmental degradation seem to be everywhere, which makes it odd that the city is still the place where most people choose to live.

Mr Reader concludes that modern cities “tread too heavily” on the environment, without much considering the alternatives. We are told that London requires an area of land 120 times its size to provide the resources it uses, but we learn little about whether dense human settlements might be better for the environment than widespread sprawl. After all, humans have to live somewhere. Worries over urban “sustainability” require better support than this. Nonetheless, readers will find much in the book to help them consider the relative merits of urban and rural life.

Cities.
By John Reader.
William Heinemann; 358 pages; £20

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New fiction

Wartime rations

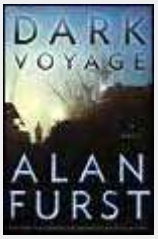
Aug 26th 2004
From The Economist print edition

ALAN FURST writes brilliantly about wartime Europe. He is without peer in his ability to explore the way that war affects individuals' lives in a purely random fashion, and the relationships between people thrown together by events that they are both powerless to control and barely understand. This reviewer is an enthusiast, devouring every new Furst novel as soon as it reaches the bookshops.

So it is painful to admit that “Dark Voyage” is something of a disappointment. Many of the familiar ingredients are there. There are characters forced by circumstance to undertake tasks for which they would not have judged themselves equipped: in this case, the captain and crew of a Dutch freighter who find themselves caught up in dangerous work for the allied war effort. There are hints of espionage, and there is romance, of a sort.

As always, Mr Furst writes with impressive authority about the factual background to his story. German attacks on allied shipping exacted a heavy toll during the early years of the war. British losses were huge, and curbing them was vital. The reader gains a keen sense of how individual efforts, apparently small in themselves, could be critical in giving Britain the edge it badly needed.

Dark Voyage
By Alan Furst



Random House; 272 pages; $24.95. Weidenfeld & Nicolson; £12.99

Buy it at
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Mr Furst also writes skilfully about those places—Lisbon and Alexandria, for instance—that were either neutral or not directly affected by the fighting. He vividly conveys how economic activity adapted to wartime conditions, and how people in these places managed to achieve something approaching normal daily life.

Yet “Dark Voyage” ultimately fails to satisfy. Mr Furst's biggest problem is the high standard he has set for himself. The very best of his novels are hard-to-put-down page-turners where the reader cares deeply about characters who are skilfully blended in with real events, which act as a well-delineated backdrop to the main narrative. With the exception of the Dutch captain of the freighter, the reader of “Dark Voyage” is not given enough to care much about where any of the characters came from, nor where they are going to.

Perhaps that is part of Mr Furst's point—such stories were to be found in a thousand places all over wartime Europe. But that is small comfort to readers who want to engage with the sort of characters they have come to expect from his pen.

Dark Voyage.
By Alan Furst.
Random House; 272 pages; $24.95. Weidenfeld & Nicolson; £12.99

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About sponsorship

Obituary

Julia Child

Aug 26th 2004
From The Economist print edition

Julia Child, cookery teacher, died on August 13th, aged 91

AP

ST PAUL saw the light on the road to Damascus, Archimedes while soaking in the bath. Julia Child's moment of illumination came in a restaurant in Rouen in 1948. The meal was simple: oysters on the half-shell, sole *meunière*, green salad, a bottle of Pouilly-Fuissé, *café filtre*. But the whole experience, she later wrote, was “an opening up of the soul and spirit for me.”

Until that moment, Mrs Child knew nothing of French food. She had never tasted *crème fraîche* or encountered a shallot. Nor had most Americans. Their menus revolved around Jell-O, Cream of Wheat and a single, rubbery, species of cheese. Almost single-handedly, Mrs Child was to change all that. Under her trilling and exuberant guidance, Americans came to embrace at least the cooking of France.

The main problem, she understood, was fear. The language was foreign, the recipes long, the ingredients difficult to get, and the whole enterprise shot through with French superiority. Mrs Child determined to show that French cooking could be fun; that even a frazzled New Yorker, after a day at the office, could cobble up a mean *boeuf bourguignon*.

Her eruption on television, in 1962, made the point superbly. She had just produced 734 pages, in two volumes, called “Mastering the Art of French Cooking”. This, the work of ten years, was still a mite intimidating. But Mrs Child appeared on set with a frying pan, a portable hot-plate, an apron, a whisk and a dozen eggs, and merrily whipped up an omelette as she was being interviewed. In the book, the process took ten pages; on screen, it took two minutes. She was launched as a star.

Americans had seen TV chefs before, but not like this one. The towering Mrs Child was a maniac with blades, never meeting a knife she didn't like; she once jointed a chicken with a sword, and was spoofed bleeding to death on “Saturday Night Live”. Dishes were tasted liberally, and fingers licked. She drank as she went, recommending a glass for any tired cook, and her sing-song aristocratic tones (“*Bon appétit*!”) grew steadily more extravagant.

Mistakes were summarily dealt with. An offending loaf was tossed over her shoulder among the potted plants; a misflipped potato pancake was scraped off the range and back into the pan; her false teeth were firmly readjusted in front of the camera. She began her demonstration of *coq au vin* by dropping a whole chicken on the floor, dusting it off and remarking: “It's OK. No one's looking.”

Behind the fun lurked a stickler for exactitude. French cooking, she believed, was about rules; it was as much science as art. As a scientist, she was obsessed with discovering how to make perfect French bread with American all-purpose flour in an American oven. It took two years, 284 pounds of flour and all the ingenuity of her husband, Paul, who lined her stove with quarry tiles and, to produce the necessary burst of steam, dropped a brick into a pan of hot water at the bottom of the oven. Within two or three decades, Americans had no need to go to the trouble; they could buy good French bread in shops across the country. But that too, you could argue, was Julia's doing.

Butter and cream

Nothing in her background made her a gourmet. She ate prodigiously as a child, but so did her equally tall sisters. Though they were a rich family, the food was poor; her mother, who kept a cook, could make only biscuits and Welsh rarebit. Julia misbehaved, and smoked her father's cigars; she remained a smoker half her life, despite the risks to a discerning palate.

She thought she might be a novelist, or preferably a spy. During the second world war she joined the Office of Strategic Services, the forerunner of the CIA, and was sent to Ceylon (now Sri Lanka); there she met Paul Child, a serious foodie as well as her first and last love. His posting to Paris sealed her fate. After the Rouen epiphany *en route*, Julia enrolled at the Cordon Bleu school in 1949; on graduation, she started her own cookery class. By this time, she had discovered that her greatest joy was shopping and eating as the French did, and teaching how to do it. She went on almost until the day she died.

As a national institution, with her turquoise kitchen and copper pans eventually enshrined in the Smithsonian, she was excused from changes in fashion. She loved red meat with a passion, while America switched squeamishly to chicken; her cookery included lashings of eggs, butter and cream, when the national waistline was alarmingly expanding. “Just slowly incorporate another stick of butter,” was Mrs Child's soothing response to emergencies with sauce. She could hardly think of another larder essential, except potatoes; and these too, when cooked, demanded to be buried in butter and cheese.

In 2000, when she was awarded the Légion d'Honneur for bringing the delights of France to Americans, she was served all her favourite things: oysters, caviar, Dover sole, duck, profiteroles and a good deal of champagne. Her life could appear one long indulgence of comfortable houses and perfect meals. Yet Julia was no snob. She encouraged all the clumsy, aspiring cooks who wrote to her and sought her autograph; and when stuck in an airport she would eat a hamburger quite happily, *comme tout le monde*.

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Overview

Aug 26th 2004
From The Economist print edition

Oil prices slid from their recent highs. The price of a barrel of West Texas Intermediate fell by almost 10% to just over $45 in New York trading.

Also in New York, **gold** prices rose to a four-month high of $413 an ounce, before falling back as oil prices, and the fears of rampant inflation that they stoked, also eased.

America's **housing market** weakened in July, despite the fact that mortgage rates remained low. The number of existing-home sales fell by 2.9%. Although sales were below their peak of earlier this year, the annual rate of sales was still the third highest on record. Sales of new homes also disappointed in July, falling by 6.4% to a seasonally adjusted annual rate of 1.13m, down from 1.21m in June.

Canada's consumer-price inflation slowed to 2.3% in the year to July from 2.5% in the year to June, thanks in part to lower petrol prices. Core inflation, however, which excludes the volatile prices of food and energy, rose.

Nominal wages in **Australia** rose by 2.9% in the year to the second quarter, a sharp drop from 5.1% growth in the year to the first quarter.

Economic growth in the **euro area** paused in July, according to EuroCOIN, an economic indicator published by Britain's Centre for Economic Policy Research. Rising industrial production was the only bright spot.

Consumer-price inflation in **Germany** rose to 2.0% in the year to August, up from 1.8% in the year to July. But wage growth slowed in June to 1.4% on the year, from 1.8% in the year to May.

Consumers in the **Netherlands** perked up. Spending rose by 1.6% in the year to June and consumer confidence rose in August. An index of industrial confidence in **Belgium** dropped sharply in August.

Switzerland's export growth fell to 3.5% in the year to July from 17% in the year to June, and imports fell by 2.4% compared with last year.

Producer-price inflation in **Spain** edged up to a 12-month rate of 4.1% in July.

Unemployment in **Sweden** fell to 5.6% in July from 5.8% in June.

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Output, demand and jobs

Aug 26th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		Unemployment % rate year ago
Australia	+ 3.2	Q1	+ 0.9	+ 3.5	+ 3.3	− 1.1	Q1	+ 7.9	Q2	5.7	Jul	6.2
Austria	+ 0.5	Q1	+ 0.8	+ 1.6	+ 2.1	+ 6.6	May	− 4.7	May	4.2	Jul	4.5
Belgium	+ 2.8	Q2	+ 3.2	+ 2.2	+ 2.1	+ 2.7	Jun	− 2.5	May	12.8	Jul†	13.0
Britain	+ 3.7	Q2	+ 3.8	+ 3.3	+ 2.7	+ 0.5	Jun	+ 6.6	Jul	4.8	Jun††	5.0
Canada	+ 1.6	Q1	+ 2.4	+ 2.9	+ 3.4	+ 3.6	May	+ 4.9	Mar	7.2	Jul	7.7
Denmark	+ 1.4	Q1	+ 3.8	+ 2.0	+ 2.2	+ 3.9	Jun	+ 4.3	Jun	6.2	Jul	6.0
France	+ 2.8	Q2	+ 3.2	+ 2.2	+ 2.2	+ 2.7	Jun	+ 4.1	Jun	9.9	Jun	9.8
Germany	+ 2.0	Q2	+ 1.9	+ 1.5	+ 1.7	+ 2.7	Jun	− 2.2	Jun	10.6	Jul§	10.6
Italy	+ 1.1	Q2	+ 1.0	+ 1.2	+ 1.8	− 0.1	Jun	− 5.3	May	8.5	Jan	8.9
Japan	+ 4.4	Q2	+ 1.7	+ 4.5	+ 2.3	+ 8.9	Jun	− 2.9	Jun	4.6	Jun	5.3
Netherlands	+ 1.0	Q2	− 0.8	+ 1.3	+ 1.8	nil	Jun	− 1.0	May‡	6.3	Jul**	5.3
Spain	+ 2.8	Q1	+ 2.6	+ 2.8	+ 2.8	+ 5.7	Jun	+ 2.1	Jun	11.1	Jun	11.3
Sweden	+ 3.4	Q2	+ 3.8	+ 2.8	+ 2.6	+ 3.4	Jun	+ 4.3	Jun	5.6	Jul†	5.0
Switzerland	+ 1.5	Q1	+ 1.6	+ 1.9	+ 2.1	+ 4.5	Q1	+ 6.2	Jun	3.6	Jul†	3.6
United States	+ 4.8	Q2	+ 3.0	+ 4.5	+ 3.5	+ 4.9	Jul	+ 5.6	Jun	5.5	Jul	6.2
Euro area	+ 2.0	Q2	+ 2.0	+ 1.8	+ 2.0	+ 2.7	Jun	+ 1.2	Jun	9.0	Jun	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q1	+ 3.0	na	na	+ 5.2	Jun	+ 3.4	Jun	7.8	Jul†	7.9
Greece	+ 3.9	Q2	− 0.6	na	na	− 1.5	Jun	+ 4.0	May	na		na
Iceland	+ 4.9	Q1	na	na	na	na		na		3.1	Jun†	3.2
Ireland	+ 6.1	Q1	na	na	na	+ 4.2	Jun	+ 3.3	Jun	4.4	Jul	4.8
Luxembourg	+ 2.1	2003	na	na	na	− 1.2	Dec	+ 2.3	Mar	3.9	Jun	3.5
New Zealand	+ 4.4	Q1	+ 8.1	na	na	+ 5.5	Q1	+ 6.8	Q2	4.0	Q2	4.7
Norway	+ 2.9	Q1	+ 3.9	na	na	+10.4	Jun	+ 5.3	Jun	4.6	Q2	4.7
Portugal	+ 0.1	Q1	+ 2.4	na	na	− 0.2	Jun	+ 5.2	Jun	6.3	Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Apr-Jun; claimant count rate 2.7% in Jul. §EU harmonised rate 9.9% in Jul. **May-Jul.

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Prices and wages

Aug 26th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.7	+ 2.5	+ 2.5	+ 2.8	Q2	+ 0.2	+ 2.9	Q2	+ 5.5
Austria	+ 2.3	Jul	+ 1.1	+ 1.6	+ 1.5	+ 6.0	Jul	+ 1.2	+ 2.2	Jun	+ 2.1
Belgium	+ 2.4	Jul	+ 1.5	+ 1.8	+ 1.6	+ 4.2	Jun	− 0.8	+ 2.3	Apr	+ 1.7
Britain	+ 1.4	Jul*	+ 1.3	+ 1.5	+ 1.8	+ 2.5	Jul	+ 1.3	+ 4.4	Jun†	+ 3.0
Canada	+ 2.3	Jul	+ 2.2	+ 2.0	+ 2.1	+ 6.4	Jun	− 2.7	+ 2.6	May	+ 3.0
Denmark	+ 1.3	Jul	+ 1.9	+ 1.3	+ 1.9	+ 2.7	Jul	− 0.1	+ 3.3	Q1	+ 3.9
France	+ 2.3	Jul	+ 1.9	+ 2.1	+ 1.7	+ 2.2	Jun	+ 0.9	+ 2.8	Q1	+ 2.9
Germany	+ 2.0	Aug	+ 1.1	+ 1.6	+ 1.2	+ 3.9	Jul	nil	+ 1.4	Jun	+ 2.0
Italy	+ 2.3	Jul	+ 2.7	+ 2.3	+ 2.1	+ 3.2	Jun	+ 1.5	+ 3.3	Jun	+ 1.7
Japan	nil	Jun	− 0.4	− 0.1	+ 0.3	+ 1.6	Jul	− 0.8	+ 0.8	Jun	+ 4.0
Netherlands	+ 1.1	Jul	+ 2.1	+ 1.5	+ 1.4	+ 3.7	Jun	+ 1.2	+ 1.2	Jul	+ 2.6
Spain	+ 3.4	Jul	+ 2.8	+ 2.8	+ 2.6	+ 4.1	Jul	+ 1.1	+ 3.2	Q1	+ 4.9
Sweden	+ 0.7	Jul	+ 1.8	+ 0.8	+ 1.6	+ 1.9	Jul	− 1.5	+ 2.0	May	+ 2.6
Switzerland	+ 0.9	Jul	+ 0.2	+ 0.7	+ 1.1	+ 1.3	Jul	− 0.7	+ 1.4	2003	+ 1.8
United States	+ 3.0	Jul	+ 2.1	+ 2.6	+ 2.3	+ 4.0	Jul	+ 2.9	+ 1.9	Jul	+ 2.9
Euro area	+ 2.3	Jul	+ 1.9	+ 2.0	+ 1.7	+ 2.4	Jun	+ 1.4	+ 2.5	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.3	Jul	+ 0.4	na	na	+ 1.5	Jul	− 0.4	+ 3.5	Q2	+ 4.4
Greece	+ 2.9	Jul	+ 3.6	na	na	+ 1.9	Jun	+ 3.1	na		na
Iceland	+ 3.7	Aug	+ 2.0	na	na	+ 5.2	Jul	+ 3.3	+ 5.1	Jul	+ 5.7
Ireland	+ 2.7	Jul	+ 3.1	na	na	+ 1.3	Jun	−10.6	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.4	Jul	+ 1.6	na	na	+ 9.0	Jun	+ 2.3	− 0.4	Dec	+ 0.7
New Zealand	+ 2.4	Q2	+ 1.5	na	na	+ 1.5	Q2	− 1.9	+ 2.3	Q2	+ 2.3
Norway	+ 1.5	Jul	+ 1.5	na	na	+13.6	Jul	+ 6.3	+ 4.6	Q1	+ 5.3
Portugal	+ 2.8	Jul	+ 2.9	na	na	+ 4.2	Jul	− 0.4	+ 1.3	May	− 1.9

*New series. RPI inflation rate in July: 3.0%. †Apr-Jun.

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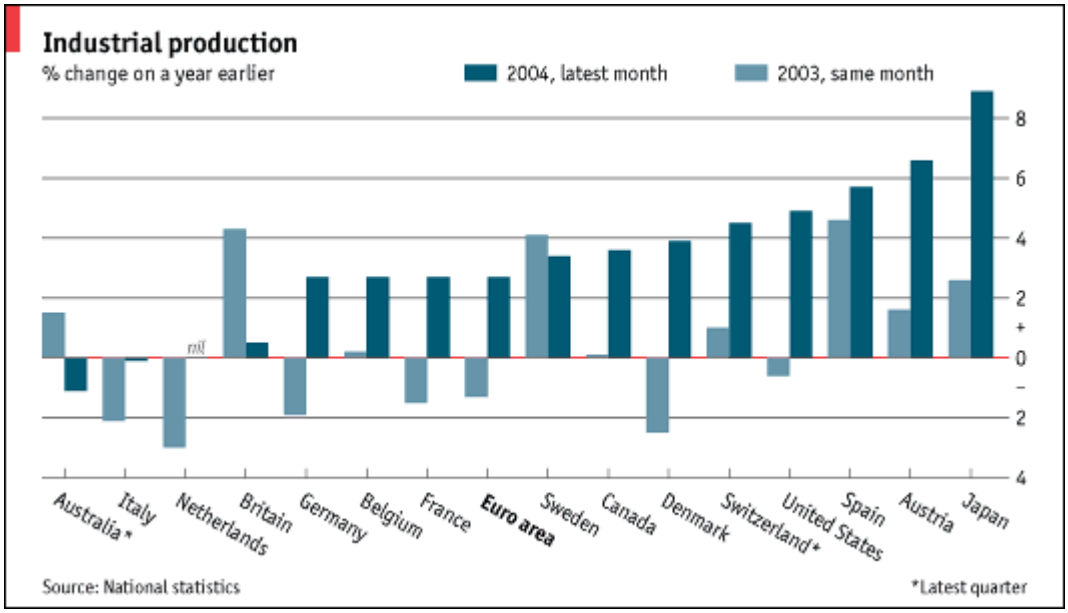
Industrial production

Aug 26th 2004
From The Economist print edition



As global economic growth has perked up over the past year, factories in most rich countries have become much busier. Industrial-output growth in Japan has been especially strong, rising to 8.9% during the year to June from 2.6% in the previous 12 months. Britain was one of the few countries to experience an industrial-production slowdown; growth slid to 0.5% in the 12 months to June from 4.3% the year before.

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Money and interest rates

Aug 26th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Aug 25th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.4	+11.8	Jun	5.43	4.86	5.21	5.60	5.54	6.39
Britain	+ 5.6	+ 8.9	Jul	4.91	3.56	4.84	4.95	4.61	5.75
Canada	+10.8	+ 7.4	Jul	2.16	2.68	3.04	4.67	4.96	6.16
Denmark	+ 8.4	+10.3	Jul	2.25	2.30	2.43	4.15	4.35	5.43
Japan	+ 4.0	+ 1.9	Jul	0.03	0.01	0.15	1.62	1.37	1.70
Sweden	+ 2.6	+ 0.8	Jun	2.01	2.71	2.77	4.34	4.65	2.88
Switzerland	+ 3.8	+ 3.0	Jul	0.58	0.27	1.07	2.72	2.66	2.41
United States	+ 4.0	+ 4.8	Jul	1.64	1.04	2.47	4.26	4.46	5.75
Euro area†	+10.1	+ 5.5	Jul	2.12	2.15	2.48	4.03	4.16	3.84

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.04%, Japan No. 262 1.61%. Central bank rates: US fed funds 1.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Aug 26th 2004
From The Economist print edition

1995=100

	Aug 17th	Aug 24th*	% change on one month	% change on one year
Dollar index				
All items	89.3	90.5	+ 0.2	+13.4
Food	82.6	84.6	– 0.2	+ 7.0
Industrials				
All	98.5	98.6	+ 0.7	+21.9
Nfa†	90.5	92.6	+ 0.6	+ 8.1
Metals	105.3	103.7	+ 0.7	+34.8
Sterling index				
All items	77.1	79.5	+ 1.8	– 0.8
Euro index				
All items	95.3	98.2	– 0.2	+ 1.8
Yen index				
All items	104.6	105.5	– 1.0	+ 5.7
Gold				
$ per oz	403.25	405.43	+ 4.5	+11.9
West Texas Intermediate				
$ per barrel	46.77	45.21	+ 8.1	+41.7

* Provisional. † Non-food agriculturals.

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Stockmarkets

Aug 26th 2004
From The Economist print edition

Market indices

	Aug 25th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,530.4	3,565.3	3,274.9	+ 1.2	– 1.0	+ 6.8	+ 0.3
Austria (ATX)	1,981.6	2,047.0	1,568.9	– 3.0	– 3.2	+28.2	+23.0
Belgium (Bel 20)	2,530.0	2,530.0	2,244.2	+ 2.1	–31.3	+12.7	+ 8.1
Britain (FTSE 100)	4,411.6	4,575.7	4,287.0	+ 1.3	–36.3	– 1.5	– 0.9
Canada (Toronto Composite)	8,371.4	8,898.8	8,123.5	+ 1.8	–26.5	+ 1.8	+ 0.9
Denmark (KBX)	237.9	241.3	219.0	– 0.1	–21.2	+11.4	+ 7.0
France (SBF 250)	2,460.7	2,594.4	2,386.1	+ 1.5	–44.0	+ 2.0	– 2.1
(CAC 40)	3,595.3	3,811.4	3,465.3	+ 1.5	–48.1	+ 1.1	– 3.1
Germany (DAX)	3,788.9	4,151.8	3,647.0	+ 1.7	–53.0	– 4.4	– 8.4
Italy (BCI)	1,272.3	1,340.3	1,239.5	+ 1.3	–41.7	+ 1.2	– 2.9
Japan (Nikkei 225)	11,130.0	12,163.9	10,365.4	+ 3.3	–71.4	+ 4.2	+ 1.4
(Topix)	1,128.9	1,217.9	1,022.6	+ 3.1	–60.9	+ 8.2	+ 5.2
Netherlands (AEX)	322.1	364.8	310.7	+ 1.7	–54.1	– 4.6	– 8.5
Spain (Madrid SE)	824.0	881.7	804.4	+ 1.0	–28.1	+ 2.0	– 2.2
Sweden (Affarsvarlden Gen)	200.6	218.1	188.5	+ 2.3	–49.9	+ 6.5	+ 1.1
Switzerland (Swiss Market)	5,374.8	5,934.4	5,309.8	+ 0.9	–36.1	– 2.1	– 4.8
United States (DJIA)	10,181.7	10,737.7	9,814.6	+ 1.0	–13.1	– 2.6	– 2.6
(S&P 500)	1,105.0	1,157.8	1,063.2	+ 0.9	–27.7	– 0.6	– 0.6
(NASDAQ Comp)	1,860.7	2,153.8	1,752.5	+ 1.6	–63.1	– 7.1	– 7.1
Europe (FTSE Eurotop 300)*	965.5	1,026.2	940.9	+ 1.4	–43.4	+ 0.8	– 3.3
Euro area (FTSE Ebloc 100)*	812.3	888.3	787.2	+ 1.5	–47.6	– 2.3	– 6.3
World (MSCI)†	1,026.5	1,085.8	997.0	+ 0.8	–29.2	– 1.0	– 1.0
World bond market (Citigroup)‡	601.0	619.5	575.1	– 0.9	– 3.0	– 0.4	– 0.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Aug 26th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Aug 25th	year ago	Currency units per $ Aug 25th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.9	Jun	− 33.0	Q1	− 5.4	− 3.9	84.0	81.6	1.41	1.56	2.54	1.71	1.28	0.5
Austria	− 0.1	May	− 1.5	Jun	− 0.4	− 0.2	102.8§	103.1	0.83	0.92	1.49	–	0.75	-1.3
Belgium	+ 20.8	Jun	+ 12.2	Mar	+ 3.5	+ 3.4	102.9§	103.3	0.83	0.92	1.49	–	0.75	-0.2
Britain	− 93.6	Jun	− 39.2	Q1	− 2.4	− 2.0	104.5	99.4	0.56	0.64	–	0.67	0.50	-2.9
Canada	+ 50.0	Jun	+ 20.9	Q1	+ 2.2	+ 1.6	88.6	83.8	1.30	1.40	2.35	1.58	1.18	1.2
Denmark	+ 10.2	Jun	+ 7.1	Jun	+ 2.7	+ 2.6	106.3	106.0	6.15	6.82	11.1	7.44	5.58	0.9
France	+ 3.7	Jun	+ 0.7	Jun	+ 0.7	+ 0.8	106.3§	106.8	0.83	0.92	1.49	–	0.75	-3.8
Germany	+186.4	Jun	+ 93.7	Jun	+ 2.8	+ 2.6	104.0§	104.5	0.83	0.92	1.49	–	0.75	-3.7
Italy	+ 3.4	May	− 14.5	Jun	− 1.0	− 0.8	75.9§	76.1	0.83	0.92	1.49	–	0.75	-3.1
Japan	+128.9	Jun	+163.6	Jun	+ 3.5	+ 3.6	134.1	131.9	110	118	198	133	–	-7.1
Netherlands	+ 33.5	Jun	+ 20.7	Q2	+ 2.8	+ 2.8	102.4§	102.8	0.83	0.92	1.49	–	0.75	-3.1
Spain	− 60.1	May	− 30.0	May	− 2.9	− 2.6	77.0§	77.4	0.83	0.92	1.49	–	0.75	0.3
Sweden	+ 22.7	Jul	+ 21.2	Q1	+ 6.4	+ 5.8	80.8	79.2	7.58	8.48	13.6	9.16	6.88	0.2
Switzerland	+ 8.3	Jul	+ 37.5	Q1	+10.5	+10.2	112.5	111.5	1.27	1.41	2.29	1.54	1.16	-1.6
United States	−589.5	Jun	−537.3	Q1	− 5.2	− 4.4	97.0	105.9	–	–	1.80	1.21	0.91	-4.7
Euro area	+110.8	Jun	+ 59.7	Jun	+ 0.5	+ 0.6	90.2	88.1	0.83	0.92	1.49	–	0.75	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.5	Jun	+ 10.6	Jun	na	na	81.9§	82.2	0.83	0.92	1.49	–	0.75	1.6
Greece	− 27.8	Jun	− 9.3	Jun	na	na	59.5§	59.7	0.83	0.92	1.49	–	0.75	-3.2
Iceland	− 0.4	Jun	− 0.7	Q1	na	na	95.2**	98.2	72.2	81.2	130	87.3	65.5	0.2
Ireland	+ 41.8	Jun	− 2.1	Q1	na	na	93.9§	95.2	0.83	0.92	1.49	–	0.75	-0.5
Luxembourg	− 3.9	May	+ 3.2	Q1	na	na	102.9§	103.3	0.83	0.92	1.49	–	0.75	-1.8
New Zealand	− 2.1	Jul	− 3.4	Q1	na	na	104.6	98.6	1.53	1.75	2.75	1.85	1.39	2.9
Norway	+ 30.0	Jul	+ 29.4	May	na	na	96.5	95.7	6.88	7.65	12.4	8.32	6.24	10.4
Portugal	− 15.8	May	− 9.3	Jun	na	na	93.3**	92.9	0.83	0.92	1.49	–	0.75	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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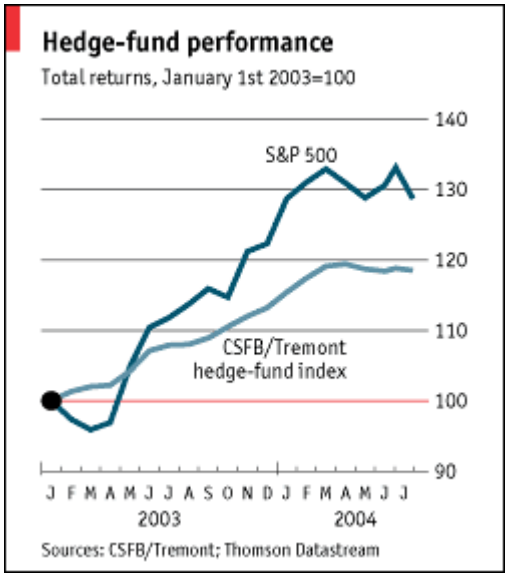
Hedge-fund performance

Aug 26th 2004
From The Economist print edition

Hedge funds as a group have underperformed America's S&P 500 index since the beginning of 2003 and returns have been mostly stagnant this year, reckons CSFB/Tremont.



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Overview

Aug 26th 2004
From The Economist print edition

Consumer-price inflation in **Singapore** fell to 1.6% in the year to July, down from 2.3% in the year to June. In **Hong Kong**, however, a rise in housing costs helped push inflation to 0.9% in the year to July, the first figure indicating positive annual CPI inflation after six years of deflation.

Venezuela's economy grew by 13.6% in the year to the second quarter, rebounding from a sharp contraction last year.

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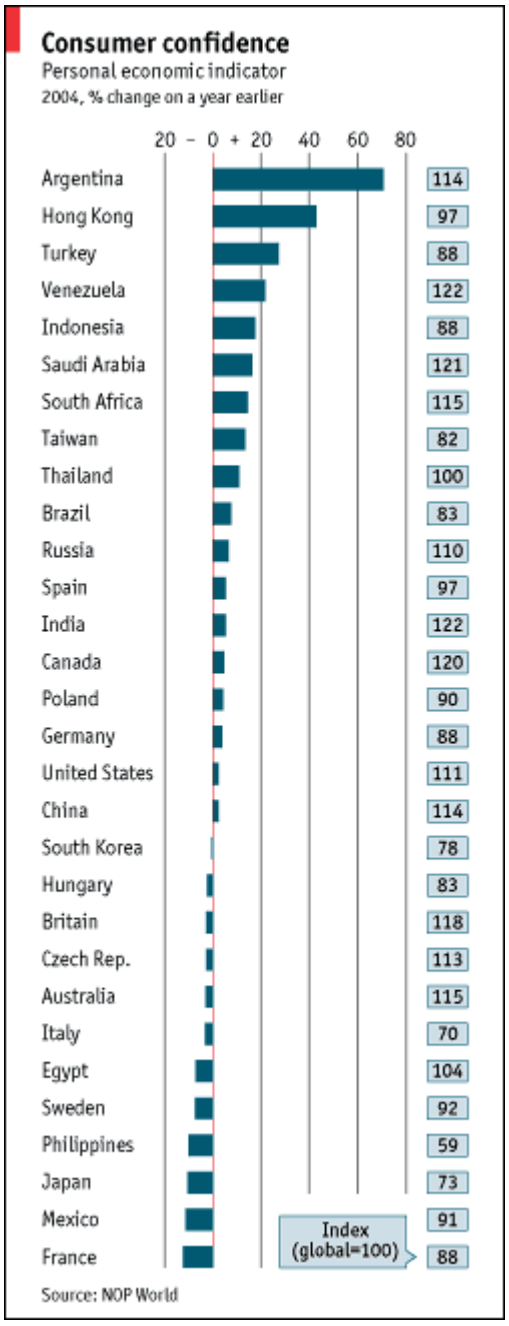
Consumer confidence

Aug 26th 2004
From The Economist print edition

Consumer confidence has risen faster in Argentina than in any other country in our chart for the second year running, according to NOP World, a research consultancy. Argentina's consumers are now as optimistic as those in China, and much more optimistic than those in Germany or Spain. Indian and Venezuelan consumers have become the most confident, while their peers in Egypt and Mexico grew more depressed.



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Economy

Aug 26th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn		Foreign reserves* $bn, latest
	GDP		Industrial production		Consumer prices		Trade balance	Current account	
China	+ 9.6	Q2	+15.5	Jul	+ 5.3	Jul	+15.7 Jul	+45.9 2003	470.6 Jun
Hong Kong	+ 6.8	Q1	+ 1.8	Q1	+ 0.9	Jul	−13.0 Jun	+14.3 Q1	118.3 Jul
India	+ 8.2	Q1	+ 7.3	Jun	+ 3.0	Jun	−17.1 Jun	+ 8.7 Q1	113.0 Jul
Indonesia	+ 4.3	Q2	+24.0	May	+ 7.2	Jul	+27.9 Jun	+ 7.4 Q4	33.7 Jun
Malaysia	+ 8.0	Q2	+13.3	Jun	+ 1.3	Jul	+19.5 Jun	+13.0 Q1	54.3 Jul
Philippines	+ 6.4	Q1	+ 2.7	Jun	+ 6.0	Jul	− 1.5 Jun	+ 3.9 Mar	12.8 Jul
Singapore	+12.5	Q2	+19.0	Jul	+ 1.6	Jul	+15.7 Jul	+27.6 Q1	100.3 Jul
South Korea	+ 5.5	Q2	+12.3	Jun	+ 4.4	Jul	+30.0 Jul	+24.6 Jun	167.9 Jul
Taiwan	+ 7.7	Q2	+15.7	Jun	+ 3.3	Jul	+12.7 Jul	+25.8 Q2	230.4 Jul
Thailand	+ 6.5	Q1	+ 9.4	Jun	+ 3.1	Jul	+ 1.7 Jun	+ 7.0 Jun	42.3 Jun
Argentina	+10.7	Q1	+ 8.3	Jul	+ 4.9	Jul	+13.4 Jun	+ 6.1 Q1	18.1 Jul
Brazil	+ 2.7	Q1	+13.0	Jun	+ 6.8	Jul	+30.9 Jul	+ 9.2 Jul	49.8 Jun
Chile	+ 5.1	Q2	+ 5.1	Jun	+ 1.4	Jul	+ 6.7 Jul	− 0.1 Q1	15.9 Jun
Colombia	+ 4.5	Q2	+11.7	Jun	+ 6.2	Jul	+ 0.2 Apr	− 1.6 Q1	11.6 Jun
Mexico	+ 3.9	Q2	+ 5.2	Jun	+ 4.5	Jul	− 5.7 Jul	− 9.1 Q1	60.4 Jun
Peru	+ 3.0	Jun	+ 7.5	Jun	+ 4.6	Jul	+ 1.5 Jun	− 0.6 Q1	10.3 Jul
Venezuela	+13.6	Q2	+24.8	May	+21.8	Jul	+20.3 Q2	+14.0 Q2	18.9 May
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	− 6.7 Q1	+ 3.9 Q1	13.3 May
Israel	+ 3.0	Q2	+ 4.2	May	+ 0.5	Jul	− 5.3 Jul	+ 0.3 Q1	26.2 Jul
South Africa	+ 1.9	Q1	+ 4.9	Jun	+ 1.6	Jul	+ 0.3 Jun	− 2.0 Q1	10.3 Jul
Turkey	+10.1	Q1	+15.7	Jun	+ 9.6	Jul	−29.8 Jun	−12.1 Jun	33.9 Jun
Czech Republic	+ 3.1	Q1	+15.1	Jun	+ 3.2	Jul	− 2.3 Jun	− 6.0 Q1	26.3 Jul
Hungary	+ 4.2	Q1	+ 8.7	Jun	+ 7.2	Jul	− 3.7 Apr	− 8.4 Apr	12.8 Jul
Poland	+ 6.9	Q1	+ 6.0	Jul	+ 4.6	Jul	− 5.5 Jun	− 3.6 Jun	34.6 Jul
Russia	+ 7.4	Q1	+ 4.4	Jul	+10.4	Jul	+69.0 Jul	+38.4 Q2	84.9 Jul
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+ 6.8	Q1	+ 6.3	Jul	+ 4.1	Jul	− 2.3 May	− 1.1 Q1	1.3 Jun
Latvia	+ 8.8	Q1	+ 7.3	Jun	+ 6.7	Jul	− 2.5 Jun	− 1.4 Jun	1.5 Jun
Lithuania	+ 6.9	Q2	na		+ 1.9	Jul	− 3.0 Jun	− 1.5 Q1	3.2 Jun
Slovakia	+ 5.5	Q1	+ 4.7	Jun	+ 8.5	Jul	− 0.7 Jun	+ 0.1 Apr	11.9 Jun
Slovenia	+ 3.7	Q1	+ 9.6	Jun	+ 3.8	Jul	− 0.9 Jun	− 0.2 Jun	8.2 May
Pakistan	+ 5.1	2003†	+ 3.3	Mar	+ 8.5	Jun	− 3.4 Jul	+ 2.4 Q1	11.2 Jun
Saudi Arabia	+ 7.2	2003	na		+ 0.4	May	+61.2 2003	+29.7 2003	21.9 Jun

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Aug 26th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Aug 25th		Dec 31st 2003	
	Aug 25th	year ago	Aug 25th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.9	3.50	1,406.0	– 1.4	– 10.4	– 10.4
Hong Kong	7.80	7.80	14.0	0.77	12,793.0	+ 4.6	+ 1.7	+ 1.3
India	46.3	45.9	83.4	4.49	5,088.6	+ 1.0	– 12.9	– 14.2
Indonesia	9,275	8,470	16,690	7.49	731.7	– 3.0	+ 5.8	– 4.0
Malaysia	3.80	3.80	6.84	2.87	807.6	– 0.2	+ 1.7	+ 1.7
Philippines	56.0	55.3	100.8	7.44	1,548.1	– 0.5	+ 7.3	+ 6.4
Singapore	1.71	1.75	3.08	1.19	1,917.1	+ 1.4	+ 8.6	+ 7.8
South Korea	1,156	1,178	2,080	3.56	804.0	+ 4.0	– 0.8	+ 2.2
Taiwan	34.0	34.1	61.2	1.10	5,661.0	+ 4.3	– 3.9	– 4.1
Thailand	41.7	41.2	75.0	1.61	607.7	+ 0.4	– 21.3	– 25.1
Argentina	2.99	2.95	5.38	5.44	942.0	– 1.1	– 12.1	– 13.8
Brazil	2.95	2.98	5.31	15.83	23,058.0	+ 1.2	+ 3.7	+ 1.4
Chile	625	699	1,125	1.68	8,121.3	+ 0.2	+ 10.7	+ 4.9
Colombia	2,572	2,855	4,628	7.78	2,943.0	+ 6.3	+ 26.1	+ 36.3
Mexico	11.4	10.9	20.5	7.32	10,237.9	+ 1.6	+ 16.4	+ 14.8
Peru	3.38	3.48	6.08	2.68	2,844.6	+ 1.0	+ 16.8	+ 19.7
Venezuela	2,596§	1,598	4,672	13.07	26,022.7	– 3.0	+ 17.2	+ 28.7
Egypt	6.23	6.18	11.20	11.04	16,855.8	+ 2.1	+ 44.8	+ 43.4
Israel	4.54	4.46	8.17	1.00	552.0	+ 3.6	+ 3.3	nil
South Africa	6.68	7.30	12.0	7.50	10,970.4	+ 2.6	+ 5.6	+ 5.6
Turkey	1,513,500	1,401,000	2,723,543	24.17	19,558.0	+ 1.5	+ 5.0	– 2.5
Czech Republic	26.3	29.9	47.2	2.65	796.2	+ 1.8	+ 20.8	+ 18.1
Hungary	206	236	371	11.19	12,003.8	+ 0.6	+ 28.0	+ 28.7
Poland	3.67	3.99	6.61	6.51	23,961.3	+ 0.9	+ 15.1	+ 17.3
Russia	29.2	32.0	52.6	13.00	558.5‡	+ 2.3	– 1.6	– 1.5
EMF (MSCI)*	1.00	1.00	1.80	na	433.9	+ 1.9	– 2.0	– 2.0
EMBI+†	1.00	1.00	1.80	na	306.6	+ 0.8	+ 4.0	+ 4.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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